Congressional
July - September 1983 [2]

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Federal Reserve Bank of St. Louis

CM

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

August 8 1983

The Honorable James L. Oberstar
House of Representatives
Washington, D. C. 20515

Dear Mr. Oberstar:

Thank you for your letter of July 27 enclosing letters you received from your constituents regarding the Board's proposal to amend Regulation Y, its regulation governing bank holding companies. Specifically, you and your constituents express concern about the proposed changes to the provisions of the regulation governing the redemption by a bank holding company of its own securities.

Currently, the Board's Regulation Y (12 CFR 225.6) requires a notice to the Board for any proposed redemption by a bank holding company of its own equity securities if the consideration paid for the shares exceeds 10 percent of the net worth of the bank holding company. The Board reviews the notice to determine whether the redemption would adversely affect the safety or soundness of the organization. Under the proposed amendments to Regulation Y, no notice would be required for any redemption if, after the redemption, the bank holding company meets the standards for adequate capitalization established by the Board of Governors and the Comptroller of the Currency. The Board generally regards these standards as the minimum for safe and sound operation of banking organizations.

The proposal also allows a bank holding company to make redemption of its stock without regard to these capital standards under two additional circumstances. First, a company may make *de minimis* redemptions equal to one percent of its net worth in any 12 month period. Second, a company may apply to the Board for its approval to make redemptions in unusual circumstances. In considering those requests, it is contemplated that the Board would consider the overall effects of the proposed redemption on the capitalization of the bank holding company.

The proposed revision of the redemption provisions emphasizes that the Board's primary concern with such redemptions is the effect they have on bank holding company capitalization. In a redemption situation, the holding company's capital is reduced through the retirement of its capital stock and, in many cases, this reduction in capital is accompanied by a corresponding increase in the indebtedness of

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the holding company to finance the redemption. In other words, in many cases, a redemption involves the substitution of debt for capital in the bank holding company. Under the proposal, the ability to make redemptions that reduce the holding company's capital and increase its indebtedness is made contingent upon the bank holding company satisfying the interagency capital standards. The proposal is premised upon the belief that a reduction in a bank holding company's capital may not be consistent with safe and sound banking practice where the holding company's capital will be below the minimum capital standards established by the Board and the Comptroller of the Currency.

The Board has received numerous comments on the proposed amendment, primarily from small banking organizations. The main thrust of the comments is directed to the fairness of the proposed provision that no redemption be permitted without prior approval where the bank holding company has a debt-to-equity ratio in excess of 30 percent following the redemption. The comments have raised concern that application of the Board's capital standards in a redemption situation will seriously limit the transferability of small banking organizations.

While the Board is concerned with adequate capitalization of bank holding companies, the Board has also recognized the unique function of small one-bank holding companies in facilitating the transfer of ownership of small banking organizations. (Policy Statement on Assessment of Financial Factors of One-Bank Holding Companies, March 28, 1980.) Because of this concern, the Board has, in proposals involving the ownership of small banking organizations, permitted liberal debt-to-equity ratios substantially in excess of the 30 percent level on the basis that the bank holding company would direct its efforts to reducing its debt-to-equity ratio over a relatively short time span in order that its improved debt capacity will allow it to serve as a source of strength should the subsidiary bank require assistance.

The Board's staff is reviewing modifications to the proposed stock redemption proposal in light of the Board's previously stated policy regarding the transfer of ownership of small banking organizations. Incorporation of this principle in the stock redemption regulation should address the concerns raised by the comments regarding the effect of the proposal on the transferability of the ownership of small banks.

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Federal Reserve Bank of St. Louis

We appreciate having your views, and your concerns will be presented to the Board when it takes action on the proposal. I will be happy to let you know when the Board reaches a final decision on the matter.

Sincerely,

(Signed) William R. Maloni
William R. Maloni
Special Assistant to the Board

VM:DJW:vcd (V-158)

bcc: Messrs. Mattingly, Bradfield, Ryan
Legal Files (2)
Mrs. Mallardi

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Federal Reserve Bank of St. Louis

CLO handling reply

JAMES L. OBERSTAR
8TH DISTRICT, MINNESOTA

COMMITTEES:
PUBLIC WORKS AND TRANSPORTATION

CHAIRMAN:
SUBCOMMITTEE ON ECONOMIC DEVELOPMENT

MERCHANT MARINE AND FISHERIES

Congress of the United States
House of Representatives
Washington, D.C. 20515

PLEASE SEND REPLY TO:
WASHINGTON OFFICE:
2351 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515
(202) 225-6211

DISTRICT OFFICES:
BRAINERD CITY HALL
501 LAUREL STREET
BRAINERD, MINNESOTA 56401
(218) 828-4400

CHISHOLM CITY HALL
316 LAKE STREET
CHISHOLM, MINNESOTA 55719
(218) 254-5761

231 FEDERAL BUILDING
DULUTH, MINNESOTA 55802
(218) 727-7474

July 27, 1983

#158

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
1983 AUG -5 PM 12: 07
RECEIVED
OFFICE OF THE CHAIRMAN

Honorable Paul A. Volcker
Chairman
Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Chairman Volcker:

I am writing to express concern about proposed changes in Section 225.4(b) of Federal Reserve Regulation Y.

The proposed regulatory changes would prove detrimental to small banks by limiting the ability of small bank holding companies to market minority stocks. In addition, these changes could eliminate employee owned stock option plans which own bank holding company stock and limit bank holding companies in estate planning.

I have enclosed letters I recently received from my constituents regarding these changes. I hope that you will consider our concerns as the Federal Reserve finalizes any revisions.

Thank you for your attention to this matter.

Sincerely,

Jim Oberstar

James L. Oberstar, M.C.

JLO/kjb

Enclosures

cc: Mr. Robert Becklin
Mr. Glenn S. Birkeland

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https://fraser.stlouisfed.org
Federal Reserve Bank of St. Louis

CAMBRIDGE, MINNESOTA 55008

July 15, 1983

Congressman James Oberstar
2351 Rayburn Office Building
Washington, D.C. 20515

Dear Congressman,

I am deeply concerned and oppose the proposed changes in Section 225.4B involving stock purchase or redemptions by bank holding companies. I oppose the changes for the following reasons:

1) The change would limit the ability for a small bank holding company to make a market in minority stock,

2) Employee Stock Ownership Plans (ESOP's) of which our holding company has a plan, which look to the holding companies for redemption of their stock, would be severly crippled,

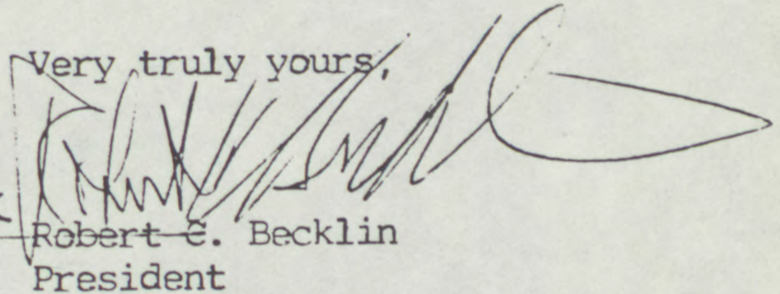
3) Redemptions from the principal's estate would be much more difficult if not impossible,

4) It would reduce the holding companies ability to sell stock to infuse capital in the subsidiary bank, and

5) Many buy/sell agreements would be unworkable.

I request that you ask the FED to consider seriously this major change, which will come down hardest on the small local bank holding companies.

Very truly yours,



Robert C. Becklin
President

DATE: 7-11 AIDE: lkc

4300

RCB/dja
Encl.

66924 45812

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Federal Reserve Bank of St. Louis

Lakeland State Bank

PEQUOT LAKES, MINNESOTA 56472 • 218/568/4025
BRANCH OFFICE: CROSSLAKE, MINNESOTA 56442

GLENN S. BIRKELAND, *President*

July 14, 1983

Congressman James Oberstar
2351 Rayburn Office Building
Washington, D. C. 20515

Dear Congressman Oberstar,

I recently received notice that the Federal Reserve Board is receiving comments on revision of Regulation Y pertaining to the ownership of small banks by one-bank holding companies. I sincerely believe that the change in the regulation, as proposed, would be very detrimental to the small banks in the United States. It is my interpretation that the one-bank holding company was implemented to allow small banks to be owned by individuals and allow the transfer of the stock.

I would urge you to work against the change in Regulation Y as now proposed by the Federal Reserve Board. Thank you very much for your cooperation.

Yours very truly,

GSB/mf

DATE: 7-18 TYPE: KK
NAME
ISSUE: 4300
PARAS:
DOC.: 66923 : 94205
COMMENTS:

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Federal Reserve Bank of St. Louis

Maplewood State Bank

WHITE BEAR AND BEAM AVENUES
P. O. BOX 2028
MAPLEWOOD, MINNESOTA 55109 (612) 777-7700

July 18, 1983

Congressman James Oberstar
2351 Rayburn Office Building
Washington, D.C. 20515

RE: Proposed Revision and Update of Regulation Y

Dear Congressman Oberstar:

Maplewood State Bank is an independent locally owned State chartered bank with assets totalling approximately thirty million dollars.

We feel that the proposed regulation will adversely affect private ownership of small banks in that it will severely limit bank holding companies as an estate planning vehicle and will limit continuity of ownership.

It will also reduce the marketability of minority interests of privately owned bank holding company stock. It also appears that it will adversely affect or eliminate employee stock option plans that own bank holding company stock.

We believe that this will place a substantial economic hardship on private owners of small banks such as ours and that small banks may be forced to file new bank holding company formation applications with the Federal Reserve System as an alternative to stock redemption.

We ask that proposed Regulation Y Section 225.4, Subdivision B, be reconsidered and eliminated.

Very truly yours,

Jack Hillstrom

G. Jack Hillstrom
President

GJH/pm

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Federal Reserve Bank of St. Louis

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

August 8 1983

The Honorable Robert T. Stafford
United States Senate
Washington, D. C. 20510

Dear Senator Stafford:

Thank you for your letter of August 2 enclosing a letter you received from Mr. George D. Milne regarding the Board's proposal to amend Regulation Y, its regulation governing bank holding companies. Specifically, Mr. Milne expresses concern about the proposed changes to the provisions of the regulation governing the redemption by a bank holding company of its own securities.

Currently, the Board's Regulation Y (12 CFR 225.6) requires a notice to the Board for any proposed redemption by a bank holding company of its own equity securities if the consideration paid for the shares exceeds 10 percent of the net worth of the bank holding company. The Board reviews the notice to determine whether the redemption would adversely affect the safety or soundness of the organization. Under the proposed amendments to Regulation Y, no notice would be required for any redemption if, after the redemption, the bank holding company meets the standards for adequate capitalization established by the Board of Governors and the Comptroller of the Currency. The Board generally regards these standards as the minimum for safe and sound operation of banking organizations.

The proposal also allows a bank holding company to make redemption of its stock without regard to these capital standards under two additional circumstances. First, a company may make de minimis redemptions equal to one percent of its net worth in any 12 month period. Second, a company may apply to the Board for its approval to make redemptions in unusual circumstances. In considering those requests, it is contemplated that the Board would consider the overall effects of the proposed redemption on the capitalization of the bank holding company.

The proposed revision of the redemption provisions emphasizes that the Board's primary concern with such redemptions is the effect they have on bank holding company capitalization. In a redemption situation, the holding company's capital is reduced through the retirement of its capital stock and, in many cases, this reduction in capital is accompanied by a corresponding increase in the indebtedness of

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the holding company to finance the redemption. In other words, in many cases, a redemption involves the substitution of debt for capital in the bank holding company. Under the proposal, the ability to make redemptions that reduce the holding company's capital and increase its indebtedness is made contingent upon the bank holding company satisfying the interagency capital standards. The proposal is premised upon the belief that a reduction in a bank holding company's capital may not be consistent with safe and sound banking practice where the holding company's capital will be below the minimum capital standards established by the Board and the Comptroller of the Currency.

The Board has received numerous comments on the proposed amendment, primarily from small banking organizations. The main thrust of the comments is directed to the fairness of the proposed provision that no redemption be permitted without prior approval where the bank holding company has a debt-to-equity ratio in excess of 30 percent following the redemption. The comments have raised concern that application of the Board's capital standards in a redemption situation will seriously limit the transferability of small banking organizations.

While the Board is concerned with adequate capitalization of bank holding companies, the Board has also recognized the unique function of small one-bank holding companies in facilitating the transfer of ownership of small banking organizations. (Policy Statement on Assessment of Financial Factors of One-Bank Holding Companies, March 28, 1980.) Because of this concern, the Board has, in proposals involving the ownership of small banking organizations, permitted liberal debt-to-equity ratios substantially in excess of the 30 percent level on the basis that the bank holding company would direct its efforts to reducing its debt-to-equity ratio over a relatively short time span in order that its improved debt capacity will allow it to serve as a source of strength should the subsidiary bank require assistance.

The Board's staff is reviewing modifications to the proposed stock redemption proposal in light of the Board's previously stated policy regarding the transfer of ownership of small banking organizations. Incorporation of this principle in the stock redemption regulation should address the concerns raised by the comments regarding the effect of the proposal on the transferability of the ownership of small banks.

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We appreciate having your constituent's views, and his concerns will be presented to the Board when it takes action on the proposal. I will be happy to let you know when the Board reaches a final decision on the matter.

Sincerely,
(Signed) William R. Maloni

William R. Maloni
Special Assistant to the Board

VM:DJW:vcd (V-156)

bcc: Messrs. Mattingly, Bradfield, Ryan
Legal Files (2)
Mrs. Mallardi

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Federal Reserve Bank of St. Louis

ROBERT T. STAFFORD
VERMONT
WASHINGTON OFFICE:
133 HART SENATE OFFICE BUILDING
TEL: (202) 224-5141
VERMONT OFFICES:
27 SOUTH MAIN STREET
RUTLAND, TEL: 775-5446
1 MAIN STREET
CHAMPLAIN MILL—4TH FLOOR
WINOOSKI, TEL: 951-6707

United States Senate

WASHINGTON, D.C. 20510

COMMITTEES:
ENVIRONMENT AND PUBLIC WORKS, CHAIRMAN
LABOR AND HUMAN RESOURCES
EDUCATION SUBCOMMITTEE, CHAIRMAN
VETERANS' AFFAIRS
NEAL J. HOUSTON
ADMINISTRATIVE ASSISTANT

August 2, 1983

#156

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
1983 AUG -4 AM 9: 35
RECEIVED
OFFICE OF THE CHAIRMAN

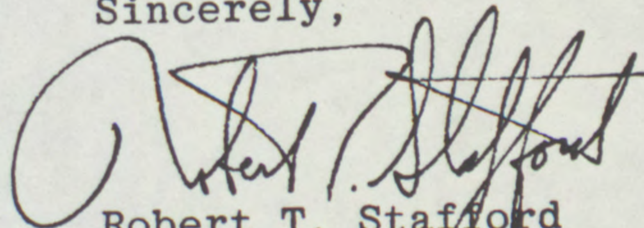
Mr. Paul A. Volcker
Chairman
Board of Governors of
The Federal Reserve System
Constitution Ave. & 21st Street
Washington, D.C. 20551

Dear Mr. Chairman:

Enclosed is a copy of a July 28th letter from Mr. George D. Milne, President of Granite Savings Bank, concerning proposals by the Board of Governors of the Federal Reserve System for revisions in Regulation Y.

I would like to bring Mr. Milne's concerns to your personal attention and appreciate any information that you may be able to provide me relating to this matter.

Sincerely,



Robert T. Stafford
United States Senator

RTS:mfr

Enclosure

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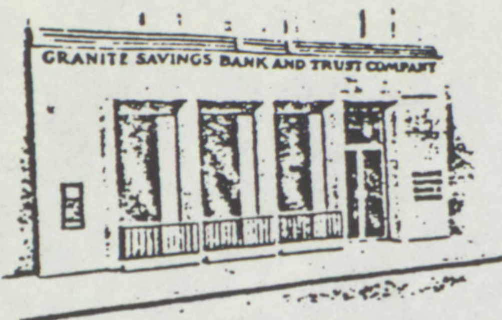
Federal Reserve Bank of St. Louis



GRANITE SAVINGS BANK
and Trust Company

BARRE, VERMONT 05641
802 476-3147

MEMBER FDIC

GEORGE D. MILNE
PRESIDENT & TRUST OFFICER

July 28, 1983

Mr. William W. Wiles, Secretary
Board of Governors of Federal Reserve System
20th and Constitution Ave., N.W.
Room 2223
Washington, D.C. 20551

Re: Comments Regarding Proposed Revision of Regulation Y
Docket No. R-0470

Dear Mr. Wiles:

We urge that Section 225.4(b) be redrafted to continue to allow small banks to redeem their stock as is presently permitted.

The Federal Reserve Bank Board has supported the use of the One Bank Holding Company as a means of making a market for the stock of small banks and a continuation of the support is needed.

Section 225.4(b), as proposed, is weighted towards the larger banks and to the detriment of the small banks as it removes the marketability of the small banks' stock, while the large banks already have established markets for their stock.

I hope the Board will reconsider and eliminate this proposed rule and continue on the same basis as presently exists.

Thank you for your consideration.

Yours very truly,

George D. Milne

George D. Milne, President

GDM/nsg

cc: Senator Stafford
Senator Leahy
Representative Jeffords

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Federal Reserve Bank of St. Louis

August 8, 1983

The Honorable Lloyd Bentsen
United States Senator
912 Federal Building
Austin, Texas 78701

Dear Senator Bentsen:

Thank you for your letter of July 5 concerning correspondence you received from Mr. Keith McGarrahan of Preston Securities in Arlington, Texas. Mr. McGarrahan also had written directly to the Board, and for your information I am pleased to enclose a copy of Chairman Volcker's response to him.

I hope this information is helpful. Please let me know if I can be of further assistance.

Sincerely,

(Signed) Anthony F. Cole

Anthony F. Cole
Special Assistant to the Board

Enclosure

RSP:AFC:vcd (V-123)

bcc: Mr. Plotkin
Mr. Ryan
Mrs. Mallardi

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Federal Reserve Bank of St. Louis

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

PAUL A. VOLCKER
CHAIRMAN

August 2, 1983

Mr. Keith McGarrahan
Vice President
Preston Securities
424 Lamar Boulevard East, Suite 210
Arlington, Texas 76011

Dear Mr. McGarrahan:

I am responding to your most recent letter dated July 5, 1983, complaining about the Federal Reserve's administration of margin regulations. I am informed by staff that you have corresponded with the System on numerous occasions in the past concerning a number of individual securities which you were seeking to have placed on the Board's over-the-counter (OTC) list of securities.

As you are obviously aware, economic benefits can be realized by market makers and brokers when the margin status of a security is changed by its placement on the OTC list. It is precisely for this reason that the Board insists that the margin regulations be administered fairly and impartially and that objective criteria be used in the addition or deletion of specific securities. All of the securities that have been the subject of your various inquiries have been and continue to be reviewed in accordance with these established procedures. Our records indicate that in the past two years you have expressed interest in the margin status of six stocks; two of these have subsequently been added to the list, following the established procedures, and, as I believe you have been previously advised, three more are candidates for the next revision of the list in October 1983.

I might note that the Federal Reserve's regulations and its implementation procedures were adopted following ample opportunity for comment and have been very favorably received in the investment community. I fully appreciate that you are anxious to obtain margin status for particular issues; however, I think you can understand that the Federal Reserve cannot compromise its impartiality in the administration of the margin regulations to accommodate individual interests.

Sincerely,

Paul A. Volcker

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Federal Reserve Bank of St. Louis

LLOYD BENTSEN
TEXAS

COMMITTEES:
FINANCE
ENVIRONMENT AND PUBLIC WORKS
JOINT ECONOMIC
JOINT COMMITTEE ON TAXATION
SELECT COMMITTEE ON INTELLIGENCE

United States Senate
WASHINGTON, D.C. 20510

July 5, 1983

#123

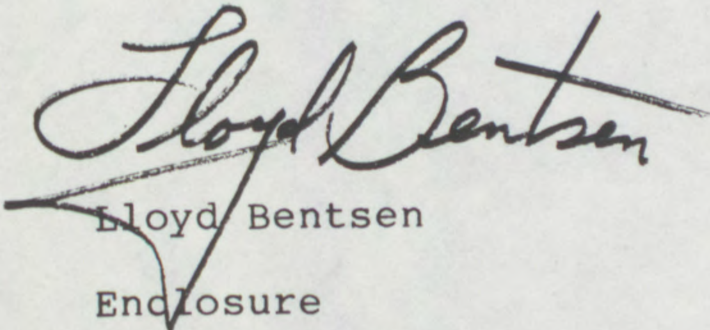
Mr. Paul S. Volcker, Chairman
Federal Reserve System
Constitution Avenue between
20th and 21st Streets, N.W.
Washington, D.C. 20551

Dear Mr. Chairman:

I am writing concerning my previous inquiry on behalf of Keith McGarrahan of Preston Securities. A copy of his most recent correspondence is attached for your reference.

I would appreciate whatever additional information or comments you may have on this matter at this time.

Sincerely,



Lloyd Bentsen

Enclosure

PLEASE REPLY TO:

912 Federal Building
Austin, Texas 78701
ATTN: Ms. Leslie Pool

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 JUL -8 AM 8:28
RECEIVED
OFFICE OF THE CHAIRMAN

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Federal Reserve Bank of St. Louis

424 LAMAR BLVD. EAST
SUITE 210

ARLINGTON, TEXAS 76011
METRO 461 · 1591

JUN 30

June 24, 1983

Senator Lloyd Bentsen
703 Hart Senate Office Building
Washington, D. C. 20510

Dear Senator Bentsen:

Here is a good example of what we are dealing with at the Fed. Mr. Ryan completely ignores in his letter (enclosed) that they had written us advising the stock would be listed if the stock did not fall below $5.00 during the survey period. Having watched the stock daily, I can tell you it never traded below $9.00 per share during the period.

You can see the problem is, Mr. Ryan and his associates do not give a damn whether one of these issues is on the list or not. It is typical of the response we've had for years.

I can't tell you what difficulty this nonsense has wrought on our company. It is just plain ridiculous that we continue to get these replies.

It is also obvious that Mr. Ryan spent little or no time on this problem. I hope you will insist that someone with responsibility and common sense be put in charge of these matters!

Yours truly,

PRESTON SECURITIES, INC.

Keith McGarrahan
Vice President

KMcG/bt
encls.

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Federal Reserve Bank of St. Louis

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

DIVISION OF BANKING
SUPERVISION AND REGULATION

June 20, 1983

Mr. Keith McGarrahan
Vice President
Preston Securities
424 Lamar Blvd. E.
Suite 210
Arlington, TX 76011

Dear Mr. McGarrahan:

This is in response to your letter of June 6, 1983 regarding the Board's List of OTC Margin Stocks. You indicate that you have not received a response to your May 19, 1983 letter, requesting information as to why the stock of Machine Technology, Inc. is not on the List. I am enclosing a copy of a letter, written May 31, 1983, explaining that stock's situation which must have crossed your letter in the mail.

Staff has informed me that the stocks of Patrick Industries Inc. and Machine Technology, Inc. are again being considered for inclusion on the List, to be revised this Fall. Survey forms requesting financial data to be used in conjunction with that revision will be sent to the companies within the next two weeks. You might also be happy to know that the stock of American Software, Inc., about which a member of your firm, Mr. Larry Huddleston inquired, is also being considered at this time.

We hope this information is satisfactory.

Sincerely,

John E. Ryan
Director

Enclosure

cc: Honorable Lloyd Bentsen
United States Senate
Washington, D.C. 20510

Honorable John Tower
United States Senate
Washington, D.C. 20510

Honorable Martin Frost
United States House of Representatives
Washington, D.C 20510

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Federal Reserve Bank of St. Louis

August 8, 1983

The Honorable Bill McCollum
House of Representatives
Washington, D. C. 20515

Dear Bill:

Thank you for your letter of August 1 recommending Mr. Joseph M. Mason, Jr., for a position on our Consumer Advisory Council.

I can assure you that Mr. Mason will receive full consideration when the Board selects eight new Council members later this year.

The Council provides valuable assistance in advising the Board on its implementation of consumer regulations and on other consumer-related matters, and the Board is pleased to receive recommendations for qualified individuals who can contribute to the Council's work.

Again, the Board appreciates having your recommendation.

Sincerely,

S/ Paul

CO: Pjt (#V-153)
bcc: Mrs. Bay
Mrs. Mallardi (2)

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Federal Reserve Bank of St. Louis

CLO will send response to Chairman today

BILL McCOLLUM
5TH DISTRICT, FLORIDA

COMMITTEE ON
BANKING, FINANCE AND
URBAN AFFAIRS
COMMITTEE ON
THE JUDICIARY

Congress of the United States
House of Representatives
Washington, D.C. 20515

1507 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515
(202) 225-2176

DISTRICT OFFICE:
SUITE 301
1801 LEE ROAD
WINTER PARK, FLORIDA 32789
(305) 645-3100
FROM LAKE COUNTY, TOLL FREE:
383-8541

#153

August 1, 1983

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 AUG -3 AM 10: 50
RECEIVED
OFFICE OF THE CHAIRMAN

The Honorable Paul A. Volcker
Chairman
Federal Reserve Board of Governors
20th & Constitution Ave., N.W.
Washington, D.C. 20515

Dear Mr. Chairman:

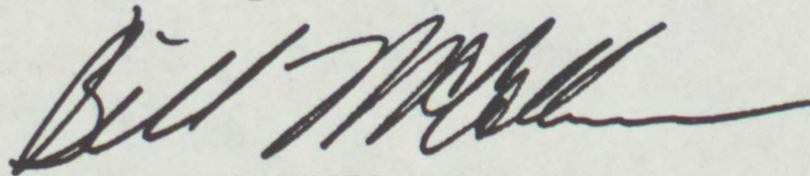
The Federal Reserve Board is currently taking nominations for openings to the Consumer Advisory Council. I would like to place in nomination to the Consumer Advisory Council, Mr. Joseph M. Mason, Jr., of Brooksville, Florida. Mr. Mason's resume is attached.

Joe Mason and I grew up together in Brooksville, Florida. We both attended the University of Florida law school and served in the Judge Advocate General's Corps in the Naval Reserve.

I can not speak highly enough of Joe Mason. He is a man of integrity, who is intelligent, articulate and well-thought-of by his friends and neighbors. You could not possibly choose a more capable and willing individual to join the Council than Joe. He would be a tremendous asset to the Council and would be an active participant from the southeastern part of the United States. Florida has not had a representative on the Consumer Advisory Council in the past few years. Therefore, I highly recommend Joe Mason to you for your consideration. I encourage you to thoroughly review Joe's qualifications, as I believe you will find him to be a valuable addition to the Consumer Advisory Council.

Thank you for your time and attention to this matter.

Sincerely,



BILL McCOLLUM
Member of Congress

BMcC/law

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Citations: Resume, Joseph M. Mason, Jr., July 29, 1983.

August 8, 1983

The Honorable Slade Gorton
Chairman
Subcommittee on Economic Policy
Committee on Banking, Housing and
  Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Chairman Gorton:

Chairman Volcker has asked that I forward to you a copy of the enclosed report on estimates of effects of interest rates on exchange rates that was prepared as a result of your request during the hearing on July 28. I have also furnished a copy to the Subcommittee staff for inclusion in the record of the hearing.

Please let me know if I can be of further assistance.

Sincerely,

(Signed) Anthony F. Cole

Anthony F. Cole
Special Assistant to the Board

Enclosure

CO:AFC:vcd

bcc: Rick Haas
Ted Truman
Mrs. Mallardi

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Insert page 25-26 (July 28, 1983 hearing before Subcommittee on Economic Policy of Senate Banking)

Chairman Volcker subsequently submitted the following information for inclusion in the record of the hearing:

Estimates of Effects of Interest Rates on Exchange Rates

The quantitative evidence on the relationship between interest rates and exchange rates should be interpreted with care. Two important points should be made at the outset. First, econometric estimates of coefficients relating interest rates and exchange rates vary a great deal depending on the period studied and, furthermore, the estimates derived from the data for any given period are not very precise in statistical terms. Second, changes in interest rates may occur in response to a variety of factors and consequently the effects on exchange rates associated with a given change in interest rates may vary substantially. For example, a decrease in the fiscal deficit, holding the money supply constant, normally would be expected to lower interest rates and also to lead to a decline in the foreign exchange value of the dollar. Similarly, an increase in the growth rate of the U.S. money supply also would normally be expected to depress both interest rates and the dollar in the short run. However, higher inflation from the monetary expansion could lead to subsequent increases in interest rates and the dollar might depreciate further to compensate for the higher U.S. inflation.

Research on the relationship between interest rates and exchange rates by the staff of the Federal Reserve Board has been conducted along two lines. The first exploits single-equation models of exchange rates, the second makes use of a large structural econometric model.

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The single-equation studies use regression analysis to explain movements in the weighted-average foreign exchange value of the dollar with several variables including interest rates and inflation rates.[1] A variety of similar equations have been estimated over various time periods. In sum, they suggest that the effect of reducing U.S. short-term interest rates by one percentage point, holding all other factors constant, ranges from a depreciation as small as 0.1 percent to a depreciation as large as almost 4 percent. The size of the coefficient relating interest rates to exchange rates (and its statistical significance) varies with the period analyzed, the frequency of the data, and with the particular specification of the equation estimated.

An alternative method of analyzing the effects of interest rates on exchange rates has been to use the large-scale Multi-Country Model (MCM) developed by the Federal Reserve Board staff. The MCM includes a model of the U.S. economy as well as models of four of its most important trading partners: Canada, Germany, Japan and the United Kingdom. In the MCM both interest rates and exchange rates are simultaneously determined by the structure of the model, responding to changes in economic policies, as well as to changes in other factors such as investors' portfolio preferences. The strength of an approach such as that of the MCM is that such models have fully articulated structures and can allow for interest rates and exchange rates to be affected in several different ways. Furthermore, this type of approach allows for the interaction both within and among economies in the form of "feedback"

1/ The "exchange rate" in these studies is a weighted average of bilateral exchange rates for the dollar against the G-10 countries and Switzerland. The weights are multilateral shares of total trade.

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effects. The potential drawback of the MCM, indeed of any model, is that simulation results are dependent on the particular model being a reasonably accurate representation of the economy in terms of both the structure specified and the coefficients of the equations. Financial sectors of international models have always proved particularly difficult to construct. The simulations discussed below are subject to these qualifications, since they take the MCM's structure, which at best reflects normal relationships, as appropriate for the analysis of a specific question in specific circumstances. In simulations with the MCM, the historical responses of exchange rates to the induced changes in interest rates are attributable solely to the initial change imposed on the model that, in turn, works through the specific structure of the model.

In the MCM, a reduction in U.S. government expenditures leads to a decrease in short-term U.S. interest rates as well as a depreciation of the dollar. After four quarters, a decline of one percentage point in U.S. short-term interest rates resulting from such a fiscal action is associated with about a 1/4 percent depreciation of the dollar and after eight quarters with a one percent depreciation.[2/] It should be noted that the longer the simulation is continued, the more the results are affected by the multiple interactions in the model.

In the MCM, an increase in the growth rate of the U.S. monetary aggregates also causes U.S. interest rates to fall and the dollar to depreciate, but a monetary expansion has different effects elsewhere in

---

2/ The depreciation of the dollar is against a multilateral, trade-weighted average of the currencies of the other four countries in the MCM, but since these are the major currencies in the 10-country average described in footnote 1, the results are roughly comparable.

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the economy--on output, inflation and the current account. Because of these different effects, a one percentage-point decline in U.S. short-term interest rates resulting from a faster expansion of the money stock is associated with 3/4 percent depreciation of the dollar after four quarters of simulation and 1.6 percent after eight quarters. A part of this depreciation in effect compensates for the higher inflation rate induced by the more expansionary monetary policy.

These two simulations show that, depending on the source of the initial change in interest rates, exchange rates may move either more or less than in proportion to the change in interest rates. In other simulations movements in interest and exchange rates need not even be positively related. For example, a simulation in the MCM of an autonomous shift by private wealth holders out of financial assets denominated in foreign currencies and into assets denominated in U.S. dollars produces a decline in U.S. interest rates and the dollar appreciates.

This brief discussion of research and analysis undertaken at the Federal Reserve Board underlines two important propositions to keep in mind when analyzing the effects of changes in interest rates on exchange rates. First, the simple correlation between the two is not all that precise. The studies using single-equations clearly demonstrate this point. Second, in more elaborate models it is crucial to specify the original source of any interest rate movement. The results of simulations with the MCM show that even if one (unrealistically) assumes that the structural relationships are known with certainty, the relationship between changes in interest rates and changes in exchange rates is not simple and cannot be captured in a single figure.

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August 8, 1983

The Honorable Mark Andrews
United States Senate
Washington, D. C. 20510

Dear Senator Andrews:

By letter dated June 17, 1983, we advised you that the proposal by Dakota Bankshares, Fargo, North Dakota, to acquire the Dakota Bank of Wahpeton, Wahpeton, North Dakota, was being processed on an expedited basis and that you would be kept apprised of any developments. The Board today approved the application, and I am pleased to enclose a copy of the Board's Order.

Please let me know if I can be of further assistance.

Sincerely,

(Signed) Anthony F. Cole

Anthony F. Cole
Special Assistant to the Board

Enclosure

VM:vcd (V-102)

bcc: Messrs. Mattingly and Bradfield
Legal Files (2)
Mrs. Mallardi

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Federal Reserve Bank of St. Louis

August 8, 1983

The Honorable Quentin N. Burdick
United States Senate
Washington, D. C. 20510

Dear Senator Burdick:

By letter dated June 17, 1983, we advised you that the proposal by Dakota Bankshares, Fargo, North Dakota, to acquire the Dakota Bank of Wahpeton, Wahpeton, North Dakota, was being processed on an expedited basis and that you would be kept apprised of any developments. The Board today approved the application, and I am pleased to enclose a copy of the Board's Order.

Please let me know if I can be of further assistance.

Sincerely,

(Signed) Anthony F. Cole

Anthony F. Cole
Special Assistant to the Board

Enclosure

VM:vcd (V-97)

bcc: Messrs. Mattingly, Bradfield
Legal Files (2)
Mrs. Mallardi

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QUENTIN N. BURDICK
NORTH DAKOTA

United States Senate #9

WASHINGTON, D.C. 20510

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
1983 JUN -6 AM 9:13
RECEIVED OFFICE OF THE CHAIRMAN

June 3, 1983

Mr. Paul Volcker
Chairman
Board of Governors of the Federal Reserve System
20th and Constitution Avenue, West
Washington, D.C. 20551

Dear Mr. Volcker,

Hopefully, by the time you receive this letter, we may have spoken by telephone. I was back in my home state of North Dakota for the Memorial Day recess.

I visited with several of my constituents who were very upset by the refusal of the Federal Reserve to grant the Application necessary for the opening of the new bank. These people were particularly upset because there is not another bank in Wahpeton, North Dakota that has local ownership of people in Wahpeton and by a company based in North Dakota.

As you may or may not know, Wahpeton, North Dakota is the county seat of Richland County with a population of approximately 10,000 people and a trade area of 20,000 to 30,000 people. The only two banks in Wahpeton are owned by the two large chain banking organizations out of Minneapolis, Minnesota, First Bank System and Northwest Bancorporation, which is now called NorWest Corporations. It is my understanding from my staff that these two Minnesota banking corporations are among the 25 largest in the United States, each having assets of 15,000,000,000 to $20,000,000,000.

The people who have contacted my office and me have indicated that they feel that these two large banking corporations have had a part in resisting this local North Dakota competition from coming into their town. They tell me that the capital-to-asset ratio is the reason used by the Federal Reserve for denying this application. Yet, they state that these two large banking corporations have a lower capital-to-asset ratio than the North Dakota Bank Holding Company. I would appreciate your giving to me the facts in this Area.

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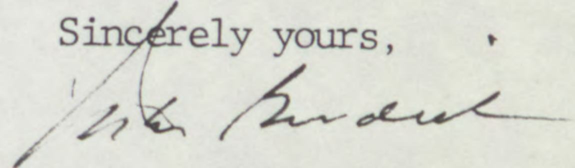
Frankly, my North Dakota constituents and I are very disappointed in any action that keeps our local people in North Dakota from competing. This new bank would have created several new job positions in Wahpeton, which certainly can be used in these difficult times for the agricultural economy.

In addition, we could certainly use the additional banking capital of $1,000,000, the deposits that would have been generated and the loans to our agricultural based economy in these pressing economic times. I would personally like to have some of your thoughts as to why this Application was denied and if there is any opportunity to revive this banking business for Wahpeton, North Dakota. I will look forward to your reply.

Sincerely yours,



Quentin N. Burdick

QNB:mfl

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Federal Reserve Bank of St. Louis

CM

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

August 5, 1983

PAUL A. VOLCKER
CHAIRMAN

The Honorable Jake Garn
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Jake:

During your address at the Eccles Building dedication ceremony last week, I first learned that Mr. Mitchell Melich of Salt Lake City was responsible for recommending to you that the Board Building be renamed after Marriner S. Eccles. In view of this role, it seems fitting that we present Mr. Melich a memento of the occasion similar to those which you and the other program participants received. I am enclosing the plaque for your transmittal to Mr. Melich.

I very much appreciated your attendance at the rededication ceremony and your participation in the program.

Sincerely,

Paul

Enclosure

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

August 4, 1983

The Honorable Ron Marlenee
House of Representatives
Washington, D. C. 20515

Dear Mr. Marlenee:

Thank you for your letter of August 1 regarding the Board's proposal to amend Regulation Y, its regulation governing bank holding companies. Specifically, you express concern about the proposed changes to the provisions of the regulation governing the redemption by a bank holding company of its own securities.

Currently, the Board's Regulation Y (12 CFR 225.6) requires a notice to the Board for any proposed redemption by a bank holding company of its own equity securities if the consideration paid for the shares exceeds 10 percent of the net worth of the bank holding company. The Board reviews the notice to determine whether the redemption would adversely affect the safety or soundness of the organization. Under the proposed amendments to Regulation Y, no notice would be required for any redemption if, after the redemption, the bank holding company meets the standards for adequate capitalization established by the Board of Governors and the Comptroller of the Currency. The Board generally regards these standards as the minimum for safe and sound operation of banking organizations.

The proposal also allows a bank holding company to make redemption of its stock without regard to these capital standards under two additional circumstances. First, a company may make _de minimis_ redemptions equal to one percent of its net worth in any 12 month period. Second, a company may apply to the Board for its approval to make redemptions in unusual circumstances. In considering those requests, it is contemplated that the Board would consider the overall effects of the proposed redemption on the capitalization of the bank holding company.

The proposed revision of the redemption provisions emphasizes that the Board's primary concern with such redemptions is the effect they have on bank holding company capitalization. In a redemption situation, the holding company's capital is reduced through the retirement of its capital stock and, in many cases, this reduction in capital is accompanied by a corresponding increase in the indebtedness of

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Federal Reserve Bank of St. Louis

the holding company to finance the redemption. In other words, in many cases, a redemption involves the substitution of debt for capital in the bank holding company. Under the proposal, the ability to make redemptions that reduce the holding company's capital and increase its indebtedness is made contingent upon the bank holding company satisfying the interagency capital standards. The proposal is premised upon the belief that a reduction in a bank holding company's capital may not be consistent with safe and sound banking practice where the holding company's capital will be below the minimum capital standards established by the Board and the Comptroller of the Currency.

The Board has received numerous comments on the proposed amendment, primarily from small banking organizations. The main thrust of the comments is directed to the fairness of the proposed provision that no redemption be permitted without prior approval where the bank holding company has a debt-to-equity ratio in excess of 30 percent following the redemption. The comments have raised concern that application of the Board's capital standards in a redemption situation will seriously limit the transferability of small banking organizations.

While the Board is concerned with adequate capitalization of bank holding companies, the Board has also recognized the unique function of small one-bank holding companies in facilitating the transfer of ownership of small banking organizations. (Policy Statement on Assessment of Financial Factors of One-Bank Holding Companies, March 28, 1980.) Because of this concern, the Board has, in proposals involving the ownership of small banking organizations, permitted liberal debt-to-equity ratios substantially in excess of the 30 percent level on the basis that the bank holding company would direct its efforts to reducing its debt-to-equity ratio over a relatively short time span in order that its improved debt capacity will allow it to serve as a source of strength should the subsidiary bank require assistance.

The Board's staff is reviewing modifications to the proposed stock redemption proposal in light of the Board's previously stated policy regarding the transfer of ownership of small banking organizations. Incorporation of this principle in the stock redemption regulation should address the concerns raised by the comments regarding the effect of the proposal on the transferability of the ownership of small banks.

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Federal Reserve Bank of St. Louis

We appreciate having your views, and your concerns will be presented to the Board when it takes action on the proposal. I will be happy to let you know when the Board reaches a final decision on the matter.

Sincerely,

(Signed) Donald J. Winn
Donald J. Winn
Assistant to the Board

VM:DJW:vcd (#V-151)

bcc: Messrs. Mattingly, Bradfield, Ryan
Legal Files (2)
Mrs. Mallardi

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Federal Reserve Bank of St. Louis

Is being handled by CLO

RON MARLENEE
MONTANA

WASHINGTON OFFICE:
409 CANNON HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515
(202) 225-1555

Congress of the United States
House of Representatives
Washington, D.C. 20515

MONTANA OFFICES:
312 9TH STREET, SOUTH
GREAT FALLS, MONTANA 59405
(406) 453-3264

2717 FIRST AVENUE, NORTH
BILLINGS, MONTANA 59101
(406) 657-6753
TOLL FREE
800-332-5965

#151

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 AUG -1 PM 9:00
RECEIVED
OFFICE OF THE CHAIRMAN

August 1, 1983

Mr. Paul A. Volcker
Chairman
Board of Governors of the
Federal Reserve System
Constitution Avenue and 21st Street
Washington, D.C. 20551

Dear Mr. Chairman:

I have become aware that the Federal Reserve Board's proposed revisions to Regulation Y will have a serious impact on private owners of small banks. Please include this letter in the official record to be considered in the final rulemaking.

The predominant concerns expressed by my banking constituents are that the proposed regulations will adversely affect private ownership of small banks by limiting bank holding companies as estate planning vehicles, limiting the continuity of ownership by reducing the marketability of minority interests of privately owned bank holding company stock, as well as affecting employee stock option plans that own such stock.

On behalf of my small business constituents, I would like to ask that the Board thoroughly review these concerns and take them into full consideration in the final rulemaking. I would also like to have a response to my letter.

Thank you for your courtesy and cooperation.

Sincerely,

Ron

Ron Marlenee
Member of Congress

COUNTIES

BIG HORN BLAINE CARBON CARTER CASCADE CHOUTEAU CUSTER DANIELS DAWSON FALLON FERGUS GARFIELD GOLDEN VALLEY HILL JUDITH BASIN MCCONE MUSSELSHELL PETROLEUM PHILLIPS POWDER RIVER PRAIRIE RICHLAND ROOSEVELT ROSEBUD SHERIDAN STILLWATER SWEET GRASS TETON TREASURE VALLEY WHEATLAND WIBAUX YELLOWSTONE

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

August 4, 1983

The Honorable Robert W. Kastenmeier
House of Representatives
Washington, D. C. 20515

Dear Mr. Kastenmeier:

Thank you for your letter of July 20 enclosing a letter you received from Mr. Carroll Callahan regarding the Board's proposal to amend Regulation Y, its regulation governing bank holding companies. Specifically, Mr. Callahan expresses concern about the proposed changes to the provisions of the regulation governing the redemption by a bank holding company of its own securities.

Currently, the Board's Regulation Y (12 CFR 225.6) requires a notice to the Board for any proposed redemption by a bank holding company of its own equity securities if the consideration paid for the shares exceeds 10 percent of the net worth of the bank holding company. The Board reviews the notice to determine whether the redemption would adversely affect the safety or soundness of the organization. Under the proposed amendments to Regulation Y, no notice would be required for any redemption if, after the redemption, the bank holding company meets the standards for adequate capitalization established by the Board of Governors and the Comptroller of the Currency. The Board generally regards these standards as the minimum for safe and sound operation of banking organizations.

The proposal also allows a bank holding company to make redemption of its stock without regard to these capital standards under two additional circumstances. First, a company may make de minimis redemptions equal to one percent of its net worth in any 12 month period. Second, a company may apply to the Board for its approval to make redemptions in unusual circumstances. In considering those requests, it is contemplated that the Board would consider the overall effects of the proposed redemption on the capitalization of the bank holding company.

The proposed revision of the redemption provisions emphasizes that the Board's primary concern with such redemptions is the effect they have on bank holding company capitalization. In a redemption situation, the holding company's capital is reduced through the retirement of its capital stock and, in many cases, this reduction in capital is accompanied by a corresponding increase in the indebtedness of

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the holding company to finance the redemption. In other words, in many cases, a redemption involves the substitution of debt for capital in the bank holding company. Under the proposal, the ability to make redemptions that reduce the holding company's capital and increase its indebtedness is made contingent upon the bank holding company satisfying the interagency capital standards. The proposal is premised upon the belief that a reduction in a bank holding company's capital may not be consistent with safe and sound banking practice where the holding company's capital will be below the minimum capital standards established by the Board and the Comptroller of the Currency.

The Board has received numerous comments on the proposed amendment, primarily from small banking organizations. The main thrust of the comments is directed to the fairness of the proposed provision that no redemption be permitted without prior approval where the bank holding company has a debt-to-equity ratio in excess of 30 percent following the redemption. The comments have raised concern that application of the Board's capital standards in a redemption situation will seriously limit the transferability of small banking organizations.

While the Board is concerned with adequate capitalization of bank holding companies, the Board has also recognized the unique function of small one-bank holding companies in facilitating the transfer of ownership of small banking organizations. (Policy Statement on Assessment of Financial Factors of One-Bank Holding Companies, March 28, 1980.) Because of this concern, the Board has, in proposals involving the ownership of small banking organizations, permitted liberal debt-to-equity ratios substantially in excess of the 30 percent level on the basis that the bank holding company would direct its efforts to reducing its debt-to-equity ratio over a relatively short time span in order that its improved debt capacity will allow it to serve as a source of strength should the subsidiary bank require assistance.

The Board's staff is reviewing modifications to the proposed stock redemption proposal in light of the Board's previously stated policy regarding the transfer of ownership of small banking organizations. Incorporation of this principle in the stock redemption regulation should address the concerns raised by the comments regarding the effect of the proposal on the transferability of the ownership of small banks.

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Federal Reserve Bank of St. Louis

We appreciate having your constituent's views, and his concerns will be presented to the Board when it takes action on the proposal. I will be happy to let you know when the Board reaches a final decision on the matter.

Sincerely,

(Signed) Donald J. Winn
Donald J. Winn
Assistant to the Board

VM:DJW:vcd (#V-141)

bcc: Messrs. Mattingly, Bradfield, Ryan
Legal Files (2)
Mrs. Mallardi

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Federal Reserve Bank of St. Louis

Action assigned to Mr. Bradfield.

ROB KASTENMEIER
2D DISTRICT, WISCONSIN

2232 HOUSE OFFICE BUILDING
PHONE: AREA CODE 202, 225-2906

HOME OFFICE:
SUITE 505
119 MONONA AVENUE
MADISON, WISCONSIN 53703
PHONE: AREA CODE 608, 264-5206

Congress of the United States
House of Representatives
Washington, D.C. 20515

COMMITTEE ON JUDICIARY

CHAIRMAN, SUBCOMMITTEE ON COURTS, CIVIL LIBERTIES AND THE ADMINISTRATION OF JUSTICE

SUBCOMMITTEE ON CIVIL AND CONSTITUTIONAL RIGHTS

SUBCOMMITTEE ON CRIME

July 20, 1983 #141

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
1983 JUL 22 AM 11: 20
RECEIVED
OFFICE OF THE CHAIRMAN

Mr. Paul A. Volcker
Chairman
Federal Reserve Board
20th & Constitution Avenue, N.W.
Washington, D.C. 20511

Dear Mr. Chairman:

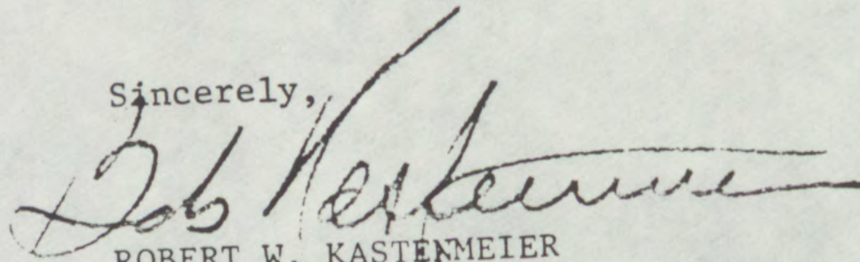
Enclosed is some correspondence I recently received from one of my constituents, Mr. Carroll B. Callahan, which I think you will find to be self-explanatory.

Would you be good enough to see that his comments are taken into account during the course of review and to let me know what the final determination is in the matter?

Thank you for your consideration and I look forward to hearing from you.

With kind regards,

Sincerely,



ROBERT W. KASTENMEIER
Member of Congress

RWK:ml
Enclosure

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Federal Reserve Bank of St. Louis

Columbus Wisconsin
53925
P. O. Box 186, 940 W. James Street

414/623-3450

CARROLL B. CALLAHAN,
President

JUL 19 1983

July 14, 1983

Representative Robert W. Kastenmeier
U.S. House of Representatives
Washington, D.C. 20515

Dear Bob:

I enclose herewith copy of a letter dated July 13, 1983 which I have sent to the Secretary, Board of Governors, Federal Reserve System. Anything you can do to help in this matter will be appreciated.

Very truly yours,

FIRST NATIONAL BANK OF COLUMBUS

By: Carroll B. Callahan, President

CBC/hs
Enclosure

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Federal Reserve Bank of St. Louis

OFFICERS
Carroll B. Callahan, President
John R. Hughes, Exec. Vice President
Donald W. Adam, Vice Pres.-Cashier
Richard N. Duborg, Vice President
R. E. Fredrick, Vice President

DIRECTORS
E. Clarke Arnold
John R. Caldwell
Carroll B. Callahan
Reuben Damm
Thomas Duffy
R. E. Fredrick
John R. Hughes
Joseph Lawlor

Columbus Wisconsin
53925
P. O. Box 186, 940 W. James Street

414 623-3450

July 13, 1983

Secretary, Board of Governors
Federal Reserve System
Washington D.C. 20051

Re: Docket No. R-0470

Dear Sir:

I just received a notice from Wisconsin Independent Bank association of Madison, Wisconsin stating that the Board of Governors of the Federal Reserve System proposed changes in it's regulation which would substantially eliminate holding company redemption of stock.

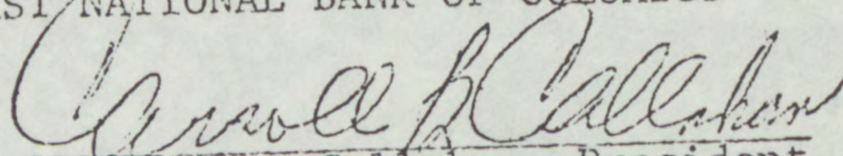
The First National Bank of Columbus, Wisconsin just recently formed a holding company and one of the prime purposes of it was so it could redeem stock.

If the changes proposed by the board are adopted, all our efforts in forming the holding company would be worthless and the expenses incurred would be a loss to the bank and to the holding company.

As President of the First National Bank, Columbus, Wisconsin, we are 100% in opposition to the proposed changes.

Sincerely yours,

FIRST NATIONAL BANK OF COLUMBUS

By: 
Carroll B. Callahan, President

CBC/hs

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Federal Reserve Bank of St. Louis

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

August 4, 1983

The Honorable Rudy Boschwitz
United States Senate
Washington, D. C. 20510

Dear Senator Boschwitz:

Thank you for your letter of July 18 regarding the Board's proposal to amend Regulation Y, its regulation governing bank holding companies. Specifically, you express concern about the proposed changes to the provisions of the regulation governing the redemption by a bank holding company of its own securities.

Currently, the Board's Regulation Y (12 CFR 225.6) requires a notice to the Board for any proposed redemption by a bank holding company of its own equity securities if the consideration paid for the shares exceeds 10 percent of the net worth of the bank holding company. The Board reviews the notice to determine whether the redemption would adversely affect the safety or soundness of the organization. Under the proposed amendments to Regulation Y, no notice would be required for any redemption if, after the redemption, the bank holding company meets the standards for adequate capitalization established by the Board of Governors and the Comptroller of the Currency. The Board generally regards these standards as the minimum for safe and sound operation of banking organizations.

The proposal also allows a bank holding company to make redemption of its stock without regard to these capital standards under two additional circumstances. First, a company may make <u>de minimis</u> redemptions equal to one percent of its net worth in any 12 month period. Second, a company may apply to the Board for its approval to make redemptions in unusual circumstances. In considering those requests, it is contemplated that the Board would consider the overall effects of the proposed redemption on the capitalization of the bank holding company.

The proposed revision of the redemption provisions emphasizes that the Board's primary concern with such redemptions is the effect they have on bank holding company capitalization. In a redemption situation, the holding company's capital is reduced through the retirement of its capital stock and, in many cases, this reduction in capital is accompanied by a corresponding increase in the indebtedness of

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the holding company to finance the redemption. In other words, in many cases, a redemption involves the substitution of debt for capital in the bank holding company. Under the proposal, the ability to make redemptions that reduce the holding company's capital and increase its indebtedness is made contingent upon the bank holding company satisfying the interagency capital standards. The proposal is premised upon the belief that a reduction in a bank holding company's capital may not be consistent with safe and sound banking practice where the holding company's capital will be below the minimum capital standards established by the Board and the Comptroller of the Currency.

The Board has received numerous comments on the proposed amendment, primarily from small banking organizations. The main thrust of the comments is directed to the fairness of the proposed provision that no redemption be permitted without prior approval where the bank holding company has a debt-to-equity ratio in excess of 30 percent following the redemption. The comments have raised concern that application of the Board's capital standards in a redemption situation will seriously limit the transferability of small banking organizations.

While the Board is concerned with adequate capitalization of bank holding companies, the Board has also recognized the unique function of small one-bank holding companies in facilitating the transfer of ownership of small banking organizations. (Policy Statement on Assessment of Financial Factors of One-Bank Holding Companies, March 28, 1980.) Because of this concern, the Board has, in proposals involving the ownership of small banking organizations, permitted liberal debt-to-equity ratios substantially in excess of the 30 percent level on the basis that the bank holding company would direct its efforts to reducing its debt-to-equity ratio over a relatively short time span in order that its improved debt capacity will allow it to serve as a source of strength should the subsidiary bank require assistance.

The Board's staff is reviewing modifications to the proposed stock redemption proposal in light of the Board's previously stated policy regarding the transfer of ownership of small banking organizations. Incorporation of this principle in the stock redemption regulation should address the concerns raised by the comments regarding the effect of the proposal on the transferability of the ownership of small banks.

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The Honorable Rudy Boschwitz
Page Three

We appreciate having your views, and your concerns will be presented to the Board when it takes action on the proposal. I will be happy to let you know when the Board reaches a final decision on the matter.

Sincerely,

(Signed) Donald J. Winn

Donald J. Winn
Assistant to the Board

VM:DJW:vcd (#V-137)

bcc: Messrs. Mattingly, Bradfield, Ryan
Legal Files (2)
Mrs. Mallardi

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RUDY BOSCHWITZ
MINNESOTA

#137

United States Senate

WASHINGTON, D.C. 20510

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 JUL 21 PM 12: 19
RECEIVED
OFFICE OF THE CHAIRMAN

July 18, 1983

Honorable Paul Volcker
Chairman, Board of Governors
Federal Reserve System
Washington, D.C. 20551

Dear Paul:

I am writing you to express my firm opposition to the Federal Reserve Board's proposed amendments to Regulation Y. I understand that comments can be submitted until August 1, 1983.

I believe that the proposed amendments would substantially, and unnecessarily, restrict the ability of small, family-owned bank holding companies to redeem bank holding company stock. As you know, many family-owned community banks -- 336 in Minnesota -- form bank holding companies to provide a market for their stock. When one of the shareholders dies, the bank holding company redeems the deceased shareholder's stock so that it need not be sold to investors outside the family or community. This redemption provides liquidity to the deceased shareholder's estate to pay estate taxes, and allows the family to maintain control of the bank.

The proposed amendments would effectively eliminate the market for bank holding company stock and substantially prohibit the transfer of stock among family members. First, allowing redemptions equal to no more than one percent of the bank holding company's net worth effectively prohibits redemptions of any significance. Second, the 6 percent consolidated capital-to-asset ratio test and the 30 percent debt-to-equity ratio test would eliminate redemptions where a bank holding company has a significant amount of debt -- even though the amount of debt is consistent with sound management judgment.

Finally, I believe the proposed amendments are unnecessary. The current regulations require that the Federal Reserve Board be notified of any redemptions of 10 percent or more of the holding company's net worth. If such a redemption would jeopardize the holding company's financial safety and soundness, the Federal Reserve Board can, in effect, veto the redemption. I believe the current regulations impose sufficient regulatory safeguards to make the proposed amendments unnecessary.

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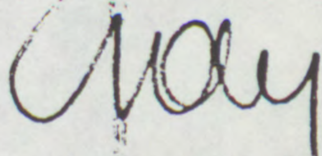
Honorable Paul Volcker
July 18, 1983
Page Two

I believe that family-owned community banks provide a great service to their communities and the country as a whole. Government regulations should not unnecessarily limit the ability to maintain family ownership. Therefore, I urge you to withdraw the proposed amendment limiting redemptions of bank holding company stock.

Thank you for your cooperation in this matter. Please contact me if I can be of assistance.

Sincerely,



Rudy Boschwitz

RB:tbm

cc: William Wiles, Secretary

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August 3, 1983

The Honorable Claiborne Pell
United States Senate
Washington, D. C. 20510

Dear Clairborne:

I wanted to thank you for putting my remarks at Bryant College in the Congressional Record. Your incoming letter was inadvertently misplaced and I did not have a chance to express my appreciation until now.

Sincerely,

S/ Paul

CO:DJW:vcd

bcc: Mrs. Mallardi (2)

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Federal Reserve Bank of St. Louis

Winn
Mrs. Mallardi
(V-136)

August 3, 1983

The Honorable Ben Erdreich
House of Representatives
Washington, D. C. 20515

Dear Mr. Erdreich:

Chairman Volcker has asked me to respond to your letter of July 18, 1983, in which you requested an outline of current restrictions on the nonbanking activities of bank and thrift holding companies that would be eliminated, altered, or unchanged by the Administration's proposed Financial Institutions Deregulation Act of 1983.

I am pleased to provide the enclosed table which compares, in chart form as you requested, the regulation of nonbanking activities under existing law and the proposed bill. We have added a category of "new restrictions imposed" since the bill would impose new restrictions in certain areas. The Board's staff would be pleased to modify this table in any manner desired. Please let me know if I may be of any further assistance.

Sincerely,

(Signed) Donald J. Winn
Donald J. Winn
Assistant to the Board

Enclosure

JVM:MLF:rsh
V-136
GC Log 185

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Regulation of Nonbanking Activities of Bank & Thrift Holding Companies under the Financial Institutions Deregulation Act of 1983

	Current restrictions remaining	Current restrictions eliminated	Current restrictions altered	New restrictions imposed
Nonbanking activities permissible for bank holding companies	Bank holding companies could continue to engage in activities that FRB determines by order or regulation to be closely related to banking.	Bank holding companies would be authorized to engage in activities that FRB determines by regulation to be "of a financial nature," in addition to the following expressly authorized activities that are currently prohibited:	FRB would be authorized to prescribe limitations on the conduct of activities consistent with financial, managerial, safety and soundness, and other criteria. In prescribing permissible activities, FRB would be required to promote competition between bank holding companies and all other companies engaged in such activities.	
		- general insurance underwriting and brokerage activities		
		- real estate investment, development, and brokerage (limited to 5% of primary capital)		
		- operating a mutual fund; underwriting and selling shares of a mutual fund (through a separate subsidiary only)		Within one year of formation of a securities affiliate by a holding company, all subsidiary banks or thrifts of the

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Current restrictions remaining	Current restrictions eliminated	Current restrictions altered	New restrictions imposed
	- dealing in and underwriting municipal revenue bonds (through a separate subsidiary only) - operating a nonfailing thrift institution - any activity authorized as of July 1, 1983, by the FHLBB for multiple S&L holding companies (other than real estate investment and development).		holding company would be required to cease any activity authorized for a securities affiliate.
FRB approval of individual proposals to engage in nonbanking activities	Prior FRB approval of proposals to engage in nonbanking activities would be eliminated.		60-day prior notice to FRB of proposed activities would be required; FRB could issue a notice of disapproval of a proposal.
Criteria for FRB evaluation of individual proposals to engage in nonbanking activities	Public benefits test (*i.e.* balancing of public benefits, such as increased competition, gains in efficiency, against adverse effects, such as conflicts of interests		

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Current restrictions remaining	Current restrictions eliminated	Current restrictions altered	New restrictions imposed
	and undue concentration of resources) would be eliminated, but FRB could consider certain adverse effects of a proposal in deciding whether to disapprove an activity. Hearing requirement would be eliminated.		
FRB could disapprove an activity for financial or managerial reasons.		Decreased or unfair competition, undue concentration of resources, and conflicts of interest criteria would be replaced by "any practice or arrangement that may adversely affect the independence or impartiality of an affiliated bank in the provision of credit or other services or the terms on which such credit and services are made available or the availability of such credit."	In considering financial and capital adequacy, FRB would be required to give due consideration to financial resources and capital of others engaged in similar activities and could not impose capital standards higher than those required by state or federal regulations applicable to other companies engaged in such activities, unless circumstances warranted a higher capital level.

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	Current restrictions remaining	Current restrictions eliminated	Current restrictions altered	New restrictions imposed
			Safety and soundness criteria would be altered from "unsound banking practices" to "any material adverse effect on the safety and soundness or the financial condition of an affiliated bank or banks."	
Judicial review		Right of competitors to seek judicial review of FRB decisions not to disapprove bank holding company proposals to engage in nonbank activities would be eliminated.		
Supervision and examination	FRB's authority to require reports of and to examine bank holding companies would be unchanged.		FRB's authority to require reports of nonbank subsidiaries generally would be limited to kinds of reports that a publicly held corporation would be required to file with SEC, except where circumstances warranted additional information.	

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	Current restrictions remaining	Current restrictions eliminated	Current restrictions altered	New restrictions imposed
			FRB is directed "to the extent feasible" to limit examination of non-bank subsidiaries by utilizing reports of other supervisory authorities and if possible by focusing examinations on activities of non-bank subsidiaries that affect the financial condition of an affiliated bank.	
Jurisdiction	A company that owns both a bank and a thrift would continue to be subject to jurisdiction of both FRB and FHLBB.			
Transactions with affiliates		Restrictions applicable to thrifts on transactions with affiliates would be eased and same restrictions applicable to banks would apply.		New restrictions would be imposed on transactions with affiliates (e.g., all covered transactions between a bank and its holding company affiliates must be on nonpreferential terms).

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	Current restrictions remaining	Current restrictions eliminated	Current restrictions altered	New restrictions imposed
State authorized nonbank activities	States would not be prohibited from authorizing state banks to engage in activities not permissible for bank holding companies.			States may not prohibit affiliations of national banks or federal thrifts with companies engaged in activities permissible under BHC Act or S&LHC Act, respectively.
Definition of "bank"	"Bank" would continue to encompass any institution that accepts demand deposits or transaction accounts and engages in the business of making commercial loans. Federally insured thrifts and certain other institutions (e.g., Edge corporations) would continue to be exempt.			"Bank" would be redefined to include any bank that is federally insured or eligible for federal insurance (if it accepts deposits other than in a fiduciary capacity).
S&L holding companies		S&L holding companies would be authorized, subject to FHLBB review, to engage in activities authorized by FRB for bank holding companies, including specifically export trading companies, securities		Unitary S&L holding companies would be subject to restrictions applicable to multiple S&L holding companies (which essentially parallel those of bank holding companies).

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Current restrictions remaining	Current restrictions eliminated	Current restrictions altered	New restrictions imposed
	affiliates, and the operation of an insured bank (currently not permitted for multiple S&L holding companies).		Real estate investment and development authority of multiple S&L holding companies would be limited to 5% of primary capital (currently unlimited). FRB, rather than FHLBB, would have jurisdiction over securities affiliates. S&L holding companies would be required to provide 60 days prior written notice of activities to the FHLBB (currently no notice required for unitary S&L holding companies); FHLBB may apply same criteria for reviewing individual proposals as apply to bank holding company proposals.

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	Current restrictions remaining	Current restrictions eliminated	Current restrictions altered	New restrictions imposed
Service corporations				Bank and S&L service corporations would be required to limit their activities to providing clerical, data processing, and other administrative services to other depository institutions and could no longer deal with the public.

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BEN ERDREICH
6TH DISTRICT ALABAMA

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

COMMITTEE ON GOVERNMENT OPERATIONS

SELECT COMMITTEE ON AGING

#136

512 CANNON BUILDING
WASHINGTON, D.C. 20515
(202) 225-4921

DISTRICT OFFICE:
105 FEDERAL COURTHOUSE
BIRMINGHAM, ALABAMA 35203
(205) 254-0956

Congress of the United States
House of Representatives
Washington, D.C. 20515

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
1983 JUL 21 AM 9: 00
RECEIVED OFFICE OF THE CHAIRMAN

July 18, 1983

The Honorable Paul A. Volcker
Chairman
Federal Reserve System
12th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Mr. Chairman:

I appreciate knowing of your support for the draft bill prepared by the Treasury Department to authorize new nonbanking powers for bank and thrift holding companies. In my view, this legislation is extremely important and should receive prompt consideration by Congress.

In order to help facilitate action by Congress, I believe that the Board should clearly outline what current restrictions the measure lifts, what restrictions remain in place, and what restrictions are altered by the legislation. It would be most helpful if these specifications could be listed side-by-side. Although the Treasury Department has included a Section-by-Section analysis with its draft submission to Congress, I strongly believe that this additional outline is necessary. Further, the Board, in my view, is the appropriate agency to handle such a review.

I appreciate your past willingness to assist Congress in matters of this nature and thank you in advance for your attention to this request.

With warm personal regards,

Sincerely,

Ben Erdreich

Ben Erdreich
Member of Congress

BE:pmm

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Federal Reserve Bank of St. Louis

August 3, 1983

The Honorable Pete Wilson
United States Senator
Room 6S9
880 Front Street
San Diego, California 92188

Dear Senator Wilson:

Thank you for your letter of July 19 supporting the request by PV Financial, Modesto, California, for an exemption from the lending limitations imposed by section 23A of the Federal Reserve Act, 12 U.S.C. § 371c.

The Board of Governors appreciates having your views on this matter, which is currently pending before the Board. Your comments will be made part of the official record and will be given full consideration when the Board makes its final decision. I will be happy to let you know when the Board reaches a final decision.

Sincerely,

(Signed) Donald J. Winn

Donald J. Winn
Assistant to the Board

XXXXXXXXXXXXX

PN:VM:CO:DJW:pjt (V-140)
bcc: Virgil Mattingly
Pam Nardolilli
Mrs. Mallardi
G.C. Log 191
Legal Records (2)

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Action assigned to Mr. Bradfield.

JESSE HELMS, N.C., CHAIRMAN

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RUDY BOSCHWITZ, MINN.
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JOHN MELCHER, MONT.
DAVID H. PRYOR, ARK.
DAVID L. BOREN, OKLA.
ALAN J. DIXON, ILL.
HOWELL HEFLIN, ALA.

United States Senate

COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, D.C. 20510

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 JUL 22 AM 9: 41
RECEIVED
OFFICE OF THE CHAIRMAN

July 19, 1983

#140

The Honorable Paul A. Volcker
Chairman, Federal Reserve Board
20th Street and Constitution Ave., N.W.
Washington, D.C. 20551

Dear Mr. Chairman:

This letter is to inform you of my concern regarding an Agricultural Credit Corporation application by PV Financial. Presently, it is pending with the Board of Governors of the Federal Reserve System.

Specifically, there are two parts of the application being reviewed. One part is now in the Controller's Office in the legal department and is being reviewed by Suzanne L'Hernault. The second segment is with the legal staff in the Federal Reserve Board and is being reviewed by Pam Nardolilli.

It is my opinion that this is not an average, run-of-the-mill application. Special attention to this matter would appear necessary because of California's agricultural interests and development.

I am grateful for your consideration in this matter.

Sincerely,

Pete

PETE WILSON
United States Senate

PW:sw
cc: Clare Berryhill, Director of Food and Agriculture, State of California
Governor George Deukmejian

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Federal Reserve Bank of St. Louis

August 2, 1983

The Honorable Frank Annunzio
House of Representatives
Washington, D.C. 20515

Dear Mr. Annunzio:

During the hearing on July 20 you requested that I furnish additional information on Federal Reserve expenditures.

For your information, I am pleased to enclose a copy of the material I am furnishing for the hearing record.

Sincerely,

S/Paul A. Volcker

Enclosure

CO:pjt

bcc: Ann DeBeer
Mr. Allison
Mrs. Mallardi (2)

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Insert page 51   (July 20, 1983 hearing before House Banking)

Chairman Volcker subsequently submitted the following information for inclusion in the record of the hearing:

Federal Reserve System expenditures in 1982 totalled $1.1 billion, a 39.6 percent increase from 1979, or 11.8 percent on an average annual basis. This rate of increase is considerably less than the 148 percent figure cited by Mr. Annunzio during the hearing and is less than the 48.4 percent rate of growth in federal government outlays during this same period. The $1.1 billion figure represents total expenses before reimbursements from the U.S. Treasury and revenue earned from priced services are deducted. In 1982, the System received $76 million from the U.S. Treasury and earned $422 million on priced services, close to half of total System expenses.

Approximately $500 million of Reserve Bank expenses in 1982 was for salaries and other personnel expenses, and average salary per capita was $20,202. A total of $14 million was spent on travel -- an increase over 1981 of only 4.3 percent. The 1982 "other" expense figure appears to refer to the category "other building expenses". This category of expense captures payments to outside firms for contract housecleaning, maintenance of elevators, vault doors and locks, and repair to our buildings; it increased only 4.6 percent from 1981 to 1982.

The expenditure pattern during the 1979 to 1982 period has been extraordinary for the Federal Reserve Banks as they have had to adjust to new relationships with depository institutions and adjust operations to the pricing of services. The Monetary Control Act resulted in 4,500 new account relationships -- a 73 percent increase in only two years. Up until 1980, Reserve Bank employment had been decreasing at an annual rate of close to 3 percent from 1974, and unit costs had been declining approximately 2 percent per year. Following passage of the Monetary Control Act, total employment increased slightly and productivity fell off as volume of priced services declined faster than Reserve Banks were able to adjust staffing levels. In 1982 and projected for 1983 we again see declines in employment and improved productivity as Reserve Banks have made the adjustments brought about by the Monetary Control Act.

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

August 2, 1983

PAUL A. VOLCKER
CHAIRMAN

The Honorable Walter E. Fauntroy
Chairman
Subcommittee on Domestic Monetary Policy
Committee on Banking, Finance and
Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Walter:

Your two recent letters raised a number of questions about monetary policy particularly as it relates to expectations or forecasts of growth in GNP and of related variables.

You noted a seeming discrepancy in that the central tendency of FOMC members' forecasts for nominal GNP in 1984 could not be obtained by adding the central tendency of forecasts for real GNP and prices. Basically, the reason for this is that the mixes of nominal and real GNP and prices that were projected by the individual members of the Committee can vary enough one from the other that they lead to central tendencies for each of these variables that at the limit appear to be mutually inconsistent, as was the case in some degree for 1984. In addition, as you know, the growth rates of real GNP and prices will, because of the mathematics involved, always differ by a small amount from the growth rates for nominal GNP (the discrepancy being given by the product of growth rates in real GNP and prices).

You also asked how the central tendency forecasts for real growth in 1983 and 1984 compare with real growth during the first and second years of past recoveries. As compared with the average of five previous postwar recoveries in the 1954-1975 period--eliminating the exceptionally rapid recovery period beginning in 1949 and the limited recovery of 1980--the central tendencies show growth somewhat lower in the first year of the current recovery, and a shade higher in the second year. These real growth rates, and accompanying projections for unemployment and prices, should be interpreted as representing the FOMC's view as to the most likely pattern of economic developments, given the monetary and credit targets for 1983 and 1984 and the overall economic environment including fiscal policy and conditions in domestic and international financial markets. An even

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better economic performance, should it evolve, consistent with sustainment over time of economic growth and progress toward reasonable price stability would of course be both desirable and acceptable.

Sincerely,

S/ Paul

SHA:pjt (#V-145 & V-121)
bcc: Mr. Axilrod
Mrs. Mallardi (2)

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H2-109, ANNEX NO. 2
WASHINGTON, D.C. 20515
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U.S. HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON DOMESTIC MONETARY POLICY

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

NINETY-EIGHTH CONGRESS

WASHINGTON, D.C. 20515

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 JUL 26 AM 9: 14
RECEIVED
OFFICE OF THE CHAIRMAN

July 25, 1983

#105

The Honorable Paul A. Volcker
Chairman
Board of Governors
Federal Reserve System
20th and Constitution Avenue, N.W.
Washington, D. C. 20551

Dear Paul:

In accordance with the unanimous consent agreement of the Committee on Banking, Finance and Urban Affairs, I would like to tender to you the following questions:

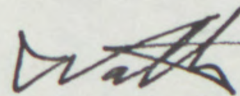
First, I have a question about the central tendencies of the FOMC's 1984 forecasts. The FOMC is projecting real GNP growth with a central tendency of 4 to 4-1/2 and inflation of 4-1/4 to 5. However, when these are added up to get nominal GNP, the results are 8-1/4 to 9-1/2, compared with the stated central tendency of 9 to 10. Indeed, a 10% nominal GNP growth rate cannot be attained given the central tendency of forecasts for inflation and real growth. What is the explanation for this discrepancy?

Second, how do the central tendencies of FOMC forecasts for real growth compare with real growth during the first and second years of real growth in past recoveries?

Third, what is the status of these forecasts? Are these growth, inflation, and unemployment rates the conditions which the FOMC would like to see, and which it will be trying to bring about through its policies? Or are these the conditions which the FOMC is afraid will happen, despite its best efforts to foster faster growth and lower inflation, because of other factors, such as large deficits and weak international conditions?

I look forward to your responses to these questions.

Sincerely yours,



Walter E. Fauntroy
Chairman

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H2-109, ANNEX NO. 2
WASHINGTON, D.C. 20515
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BILL McCOLLUM, FLA.
BILL LOWERY, CALIF.
JOHN HILER, IND.

U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-EIGHTH CONGRESS
WASHINGTON, D.C. 20515

July 7, 1983

The Honorable Paul A. Volcker
Chairman
Board of Governors
Federal Reserve System
20th and Constitution Avenue, N.W.
Washington, D. C. 20551

Dear Paul:

As you might imagine, I read with some degree of concern the story in this morning's Washington Post which suggested that the Federal Reserve might well tighten credit within the next week.

I raise this issue with you for several reasons. Rates have already begun to rise without any apparent assist from the Federal Reserve. My fear is that intervention by the Federal Reserve to raise rates further would inadvertently stifle the recovery. You may recall that during hearings held by this Subcommittee in December, 1982, a number of witnesses suggested that the considerable slack in the economy as the result of the continued high levels of unemployment would vitiate the renewal of inflationary pressures. Indeed, it was stated that there would be no renewal of inflation over the next five years due to the enormous heavy downward momentum on inflation that comes from high unemployment. Another witness pointedly said that there was simply no empirical evidence that one should worry that a high rate of growth in the economy will cause inflation when unemployment was still 8%. [Alternative Anti-Inflation Policies to Reduce Unemployment before the Subcommittee on Domestic Monetary Policy of the House Committee on Banking, Finance and Urban Affairs, 97th Cong., 2nd Sess. 103 (1982)]

At a subsequent hearing on June 1, 1983, Preston Martin testified before this Subcommittee that the Federal Reserve would support the recovery. In response to a specific question from me, he said that a 6-7% real growth for this calendar year was a little bit stronger by 1/2 to 3/4 of a point than was previously predicted but that we should applaud, not worry about such a growth rate at this point. More importantly, he said it was monetary policy's job to accommodate that higher rate of recovery. [Unpublished transcript, Hearings on Unemployment and Inflation before the Subcommittee on Domestic Monetary Policy of the House Committee on Banking, Finance and Urban Affairs, 98th Cong., 1st Sess. 61 (1983)]

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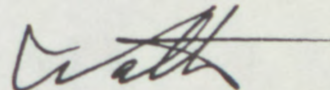
My concerns, therefore, center around whether or not the Fed has reversed the position which Preston Martin enunciated; whether there has been some major change in the economic circumstances which warrant such action; and what the potential impact rising rates would have on the international debt crisis. I am also concerned with the impact that any actions might have on mortgage rates, and on medium term rates necessary for purchases such as automobiles and heavy appliances. Housing and consumer spending are key components of this recovery, and I fear that higher rates will stop them in their tracks. If, therefore, some constraint is necessary, I would like to discuss this with you prior to any actions with a view of seeking some mechanism which would not interfere with the upward movement of the recovery. Perhaps some constraints on unproductive lending could be encouraged.

I would be pleased to discuss this with you at your earliest convenience. Perhaps several members of the Board and the FOMC could join us.

With kindest personal regards, I am

Sincerely yours,



Walter E. Fauntroy
Chairman

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HEARINGS ON UNEMPLOYMENT AND INFLATION

Wednesday, June 1, 1983

House of Representatives,

Subcommittee on Domestic Monetary Policy,

Committee on Banking, Finance and
Urban Affairs,

Washington, D.C.

Committee Hearings

of the

U.S. HOUSE OF REPRESENTATIVES

OFFICE OF THE CLERK
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1396 Mr. FAUNTROY. Mr. Martin, there have been persistent
1397 questions as to the type of recovery that the Fed would like
1398 to see happen. On the one hand the Fed could be trying to
1399 foster recovery with real growth in the fist year or so
1400 comparable to past recoveries, 6 to 7 percent. Even at the
1401 risk of modest rebound of inflation from the current 3 to 4
1402 percent rate.

1403 On the other hand, the Fed could be trying to foster a
1404 recovery with a slower rate of real growth the first year or
1405 so, say, of about 5 percent, in order to hold inflation at
1406 those rates. Since the choice of these two courses
1407 obviously has implications for employment, I wonder if you
1408 would tell the committee which of these kinds of recovery
1409 the Federal Open Market Committee, and you personally, would
1410 like to see happen; and, specifically, if real growth this
1411 year turns out to be taking space at 6 to 7 percent, at that
1412 rate, would the Federal Open Market Committee view that as
1413 an overheated expansion which should be restrained? Or as
1414 an appropriate or proper response?

1415 Mr. MARTIN. Mr. Chairman, a 6 or 7 percent real growth
1416 for this calendar year would be one in which I think we
1417 would all--we all as citizens would applaud. A 6 or 7
1418 percent real growth would mean, I think, that unemployment
1419 would decrease more rapidly than the numbers we were
1420 previously reviewing. If 6 or 7 percent could be

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1421 accomplished while inflation was kept within the 3 to 4
1422 percent rage, it would seem to me that that would be a very
1423 salutary outcome.

1424 I think our problem is that the economy has a momentum of
1425 its own that is affected by monetary policy, affected by
1426 fiscal policy, affected by these international developments.
1427 And we all are in a sense adjusting to what we are finding
1428 out there in the markets. We are finding a little bit
1429 stronger recovery by half a point or three quarters of a
1430 point than some of the consensus forecasts were just a few
1431 months ago. I think it is monetary policy's job to
1432 accommodate that higher rate of recovery. And so far we
1433 have not been constrained by leading indicators of
1434 inflation's renewal, as I have testified in the previous
1435 question.

1436 So I think my answer would be, the recovery is getting a
1437 little stronger, and it is our job to accommodate that. And
1438 so far we don't see we have to pay the price in rekindling
1439 inflation.

1440 Mr. FAUNTROY. Mr. Keehn, you have given us, as I
1441 indicated at the outset, a very pessimistic picture of
1442 unemployment, of the employment outlook in your district.
1443 You have discussed the declining population. You have
1444 talked about the closing, and you have noted with some
1445 emphasis I think the demolition, disposal of factories and

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

August 1, 1983

The Honorable Arlan Stangeland
House of Representatives
Washington, D. C. 20515

Dear Mr. Stangeland:

Thank you for your letter of July 21 regarding the Board's proposal to amend Regulation Y, its regulation governing bank holding companies. Specifically, you express concern about the proposed changes to the provisions of the regulation governing the redemption by a bank holding company of its own securities.

Currently, the Board's Regulation Y (12 CFR 225.6) requires a notice to the Board for any proposed redemption by a bank holding company of its own equity securities if the consideration paid for the shares exceeds 10 percent of the net worth of the bank holding company. The Board reviews the notice to determine whether the redemption would adversely affect the safety or soundness of the organization. Under the proposed amendments to Regulation Y, no notice would be required for any redemption if, after the redemption, the bank holding company meets the standards for adequate capitalization established by the Board of Governors and the Comptroller of the Currency. The Board generally regards these standards as the minimum for safe and sound operation of banking organizations.

The proposal also allows a bank holding company to make redemption of its stock without regard to these capital standards under two additional circumstances. First, a company may make de minimis redemptions equal to one percent of its net worth in any 12 month period. Second, a company may apply to the Board for its approval to make redemptions in unusual circumstances. In considering those requests, it is contemplated that the Board would consider the overall effects of the proposed redemption on the capitalization of the bank holding company.

The proposed revision of the redemption provisions emphasizes that the Board's primary concern with such redemptions is the effect they have on bank holding company capitalization. In a redemption situation, the holding company's capital is reduced through the retirement of its capital stock and, in many cases, this reduction in capital is accompanied by a corresponding increase in the indebtedness of

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the holding company to finance the redemption. In other words, in many cases, a redemption involves the substitution of debt for capital in the bank holding company. Under the proposal, the ability to make redemptions that reduce the holding company's capital and increase its indebtedness is made contingent upon the bank holding company satisfying the interagency capital standards. The proposal is premised upon the belief that a reduction in a bank holding company's capital may not be consistent with safe and sound banking practice where the holding company's capital will be below the minimum capital standards established by the Board and the Comptroller of the Currency.

The Board has received numerous comments on the proposed amendment, primarily from small banking organizations. The main thrust of the comments is directed to the fairness of the proposed provision that no redemption be permitted without prior approval where the bank holding company has a debt-to-equity ratio in excess of 30 percent following the redemption. The comments have raised concern that application of the Board's capital standards in a redemption situation will seriously limit the transferability of small banking organizations.

While the Board is concerned with adequate capitalization of bank holding companies, the Board has also recognized the unique function of small one-bank holding companies in facilitating the transfer of ownership of small banking organizations. (Policy Statement on Assessment of Financial Factors of One-Bank Holding Companies, March 28, 1980.) Because of this concern, the Board has, in proposals involving the ownership of small banking organizations, permitted liberal debt-to-equity ratios substantially in excess of the 30 percent level on the basis that the bank holding company would direct its efforts to reducing its debt-to-equity ratio over a relatively short time span in order that its improved debt capacity will allow it to serve as a source of strength should the subsidiary bank require assistance.

The Board's staff is reviewing modifications to the proposed stock redemption proposal in light of the Board's previously stated policy regarding the transfer of ownership of small banking organizations. Incorporation of this principle in the stock redemption regulation should address the concerns raised by the comments regarding the effect of the proposal on the transferability of the ownership of small banks.

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We appreciate having your views, and your concerns will be presented to the Board when it takes action on the proposal. I will be happy to let you know when the Board reaches a final decision on the matter.

Sincerely,

(Signed) Donald J. Winn

Donald J. Winn
Assistant to the Board

VM:DJW:vcd (V-144)

bcc: Mr. Mattingly
Mr. Bradfield
Legal Files (2)
Mr. Ryan

Mrs. Mallardi

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Mrs. Mallardi

Action assigned to Mr. Bradfield

ARLAN STANGELAND
7TH DISTRICT, MINNESOTA

COMMITTEES:
AGRICULTURE
PUBLIC WORKS AND
TRANSPORTATION

Congress of the United States
House of Representatives
Washington, D.C. 20515

OFFICES:
1526 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515
(202) 225-2165

M-F BUILDING
403 CENTER AVENUE
MOORHEAD, MINNESOTA 56560
(218) 233-8631

FEDERAL BUILDING
720 ST. GERMAIN STREET
ST. CLOUD, MINNESOTA 56301
(612) 251-0740

TOLL FREE NUMBER
(IN MINNESOTA)
1-800-422-3770

July 21, 1983

#144

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
1983 JUL 25 AM 9:47
RECEIVED
OFFICE OF THE CHAIRMAN

Mr. Paul A. Volcker
Chairman
Board of Governors of the
Federal Reserve System
Constitution Avenue and 21st Street
Washington, D.C. 20551

Dear Mr. Chairman:

I have become aware that the Federal Reserve Board's proposed revisions to Regulation Y will have a serious impact on private owners of small banks. The enclosed letters from my small banking constituents in the Seventh District of Minnesota attest to this fact. Please include the enclosed letters in the official record to be considered in the final rulemaking.

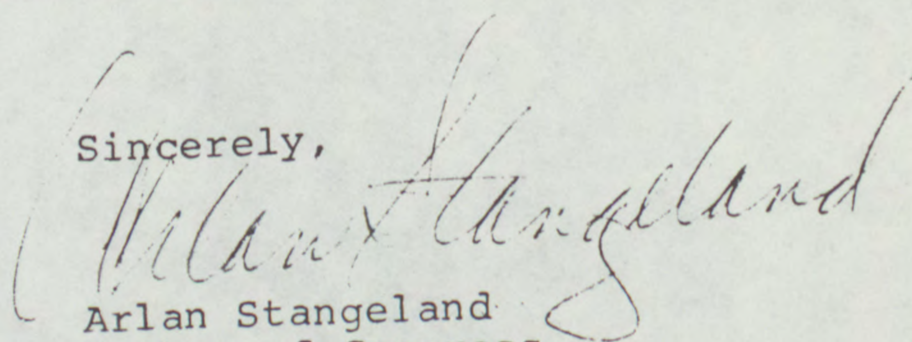
The predominant concerns expressed by my banking constituents are that the proposed regulations will adversely affect private ownership of small banks by limiting bank holding companies as estate planning vehicles, limiting the continuity of ownership by reducing the marketability of minority interests of privately owned bank holding company stock, as well as affecting employee stock option plans that own such stock.

On behalf of my small business constituents, I would like to ask that the Board thoroughly review these concerns and take them into full consideration in the final rulemaking. I would also like to be advised of the final decision on Regulation Y after the comment period is completed.

Thank you for your courtesy and cooperation.

With warm reagrds, I am

Sincerely,



Arlan Stangeland
Member of Congress

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Federal Reserve Bank of St. Louis

Heritage National Bank

2700 EAST SEVENTH AVENUE • NORTH ST. PAUL, MN 55109 • (612) 770-2341

SINCE 1910

July 14, 1983

JUL 18 1983

Docket R-0470
Secretary
Board of Governors
Federal Reserve System
Washington, D.C. 20551

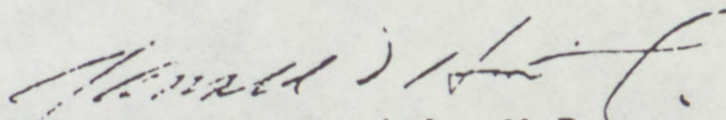
Dear Sir:

I wish to register my absolute opposition to the proposed change in Regulation Y regarding stock redemptions.

Because of the minimum standards to be imposed by the Board this proposed regulation will adversely affect private ownership of small banks in that only large corporations will be capable of purchasing said banks. It will thereby limit the market for such banks and create a concentration and hence a monopoly of financial institutions being in the hands of very small groups. It will furthermore limit the continuity of ownership and will markedly reduce the marketability of minority interests of privately owned bank and bank holding company stock.

It will furthermore adversely affect or eliminate the employee stock option plans that own bank holding company stock and thereby remove incentives which are routinely taken for granted by most corporations.

Respectfully yours,



Donald W. Herrick, M.D.
Chairman

DWH:je

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Federal Reserve Bank of St. Louis

The First National Bank of Barnesville

BARNESVILLE, MINNESOTA 56514-0218 • TELEPHONE 218-354-2201

JUL 12 1983

July 7, 1983

Board of Govenors of the Federal Reserve Bank
Docket R-0470
ECTY., Board of Govenors
Federal Reserve Bank
Washington, D.C. 20551

Gentlemen:

I am writing in opposition to the proposed change in Regulation Y regarding stock redemptions. As I decipher the proposed revisions it appears that it will have a detrimental effect on young men like me interested in getting equity in a bank holding company.

Just recently the bank holding company that has control of our bank had a stock redemption. This made it possible for me to increase my small portion of ownership in the holding company, and therefore the bank. If the regulations change, men and women with situations sililar to my own will not be able to establish equities and bank ownership will only be available to men and women who have substantial financial holdings.

I beg of you not to change the present regulations as they relate to stock redemptions.

Sincerely yours,

Kenneth E. Just
President

KEJ/ml

CC: Senator David Durenberger
Senator Rudy Boschwitz
Representative Arlan Stangeland

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Federal Reserve Bank of St. Louis

AM-CAN INVESTMENT, INC.

P. O. BOX 160
MOORHEAD, MINNESOTA 56560
Phone 233-6141

July 13, 1983

JUL 15 1983

Secretary, Board of Governors
Federal Reserve System
Washington, DC 20551

JUL 18 1983

Dear Sir:

RE: DOCKET NO. R-0470
PROPOSED SECTION 225.4(b) Purchase or redemption by a bank holding company of its own securities

It appears from the data we have reviewed that the proposed revision in regulation Y relative to bank holding company redemptions would create, if enacted, a serious problem to the buy-sell agreement currently in effect for the stockholders of our holding company. Our buy-sell agreement is structured to ensure an orderly transition for the ownership of the holding company. We feel your proposed revision will seriously impair the ability of the small holding company to function without undue regulatory interference.

AM-CAN INVESTMENT, INC.

Dennis W. Troff
President

nh

cc: ✓Representative Arlan Stangeland
Senator Rudy Boschwitz
Senator Dave Durenburger

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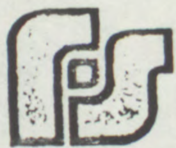

FARMERS STATE BANK of Dorset

MARK D. HEWITT
President

July 13, 1983

Congress[illegible] Arlan Stangeland
1526 Longworth Office Building
Washington, D.C. 20515

Dear Mr. Stangeland:

I am enclosing a copy of a comment letter that I have sent to the Board of Governors of the Federal Reserve System concerning proposed changes in Regulation Y. As owner of a small $10 Million Bank and Holding Company, I feel that the proposed regulation would be unfair and unnecessary and place economic hardship on private owners of small banks.
Furthermore, I feel that this proposed change of Section 225.4, Subd. (b) represents a dangerous precedent whereby a federal regulatory agency may prohibit a banking organization from conducting a standard, legal corporate practice unless that organization meets certain standards established by the regulatory agency.
I would appreciate any help you could provide in this matter.

Sincerely,

Mark D. Hewitt

Mark D. Hewitt
President

P.O. BOX 112
PARK RAPIDS, MINNESOTA 56470
(218) 732-7221

NEVIS BRANCH
P.O. BOX 305
NEVIS, MINNESOTA 56467
(218) 652-2265

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Federal Reserve Bank of St. Louis

Farmers State Bank

P O BOX 117
PARK RAPIDS, MN 54670
(218) 732-7221
(218) 652-2265

JUL 18 1983

July 13, 1983

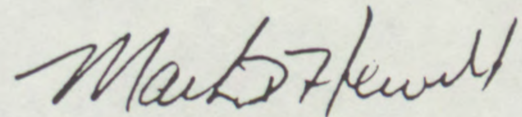
Secretary
Board of Governors of the Federal Reserve System
Washington, D.C. 20551

RE: Proposed Revision of Reg. Y

Gentlemen:

I am writing to express my strong opposition to the proposed Reg. Y Section 225.4, Subd, (b) concerning purchase or redemption by a Bank Holding company of its own securities.
I feel that the proposed Regulation will have a serious impact on private owners of small Banks, such as myself. The proposed regulation will severely limit the use of the Bank Holding company as an estate planning vehicle and will limit continuity of ownership. My heirs would not be able to use stock redemptions as a means of paying estate taxes to retain family ownership.
The proposed Regulation will markedly reduce the value of minority ownership of Bank Holding Company Stock, as the BHC will not be able to establish a market through redemptions. The use of ESOPS will also be effected.
I feel the present system of handling redemptions has proved adequate as the Board has the right to reject redemptions if it caused burdensome debt to the Holding Company. Under the proposed Reg. few small One Bank Holding Companies will be able to take advantage of a standard, legal corporate practice of stock redemptions.
In summary, I strongly urge rejection of Proposed Reg. Y Section 225.4 (Subd. b) as causing unnecessary hardship on small bank owners.
Thank-you.

Sincerely,



Mark D. Hewitt
President

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Federal Reserve Bank of St. Louis

NORTHWESTERN
STATE BANK
P.O. BOX
HALLOCK, MN
218 - 843-3641

July 12, 1983

The Honorable Arlen Stangeland, Congressman
1526 Longworth Office Building
Washington, D.C. 20515

Re:Federal Reserve Bank
Section 225-4(b)
Stock Redemption

Dear Congressman Stangeland:

The proposed changes that the Federal Reserve is contemplating making on bank holding companies will have a tremendous impact on my present and future plans for my individual bank holding companies. The way they propose it, we would have to file a complete new application and form new holding companies in order to abide by their new proposed rules and changes. In my estimation, it is completely unrealistic and impractical to have to do such a thing.

The proposed change would eliminate the ability of a small bank holding company to market its minority stock. It would also reduce the holding company's ability to sell stock to increase capital into its subsidiary bank. For estate planning, it would make it almost impossible to redeem the stock for estate purposes(many holding companies for banks were formed for this one reason alone to protect the estate). In addition, it would also cripple the ability for employee stock ownership plans. At the present time, the buy-sell agreements that I have with my other stockholders would become impractical.

The proposed criteria (6% bank capital to assets and no more than 30% debt to equity in the holding company) would have to be met under their proposed changes and approval would be much tougher and in many places almost impossible. The proposal also threatens every small bank holding company in the nation and its ownership. I request that you contact the Federal Reserve to stop rushing through such major changes and take a longer look at it to see just how serious the proposed changes would be.

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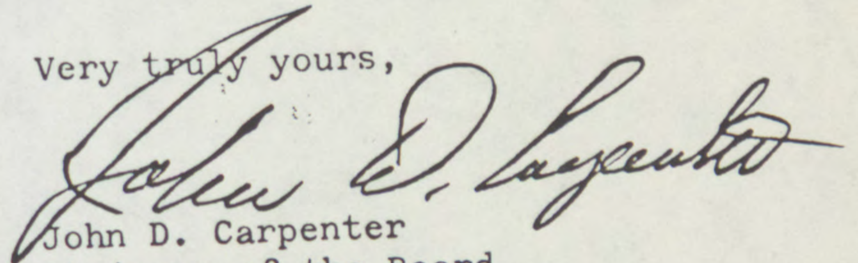
Federal Reserve Bank of St. Louis

I also question the legality of it and I would urge you to check into this to be sure that they are not proposing something that is not legal. I urge you to oppose the docket #R-0470 concerning stock redemption.

Thank you.

Very truly yours,



John D. Carpenter
Chairman of the Board
NorKitt Bancorp, Inc.
Northwestern State Bank
of Hallock, Minnesota,
Subsidiary Bank

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HAWLEY, MINNESOTA 56549

July 14, 1983

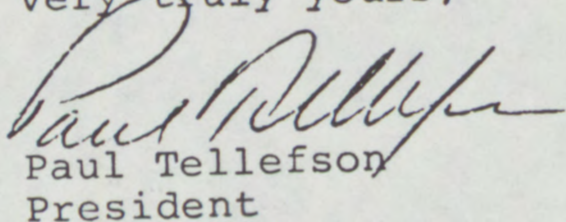
Congressman Arlan Stangeland
1526 Longworth Office Building
Washington, D.C. 20515

Dear Arlan:

Enclosed is a copy of a letter that I sent to the Board of Governors of the Federal Reserve Board expressing my concern over a change in Federal Reserve regulations which would, some time in the future, adversely affect our bank, as well as most small community banks. I would hope that, somehow, they can be convinced that the implementation of this kind of regulation is inappropriate.

Your assistance on this matter would be very much appreciated.

Very truly yours,



Paul Tellefson
President

PT:ba
Enclosed

PHONE (218) 483-3361

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Federal Reserve Bank of St. Louis

State Bank of Hawley

HAWLEY, MINNESOTA 56549

July 8, 1983

Secretary
Board of Governors
Federal Reserve System
Washington, D.C. 20551

RE: Proposed changes in regulations regarding holding company redemption of its equity securities

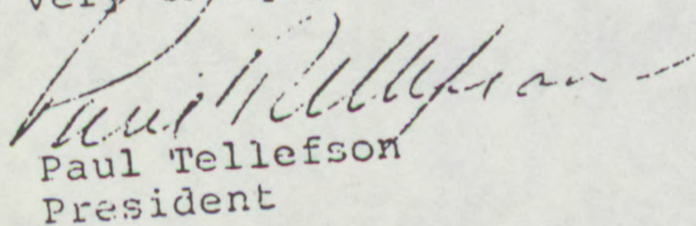
Dear Sir:

A recent survey by Arthur Anderson and Company indicates that by 1990, the number of banks in the United States will have dropped to 9600, with the majority of that reduction coming in the small to medium size banks. I believe that the proposed change in regulations would do much to expedite that change.

Our bank is located in a small town in which there is another independently owned bank, both of which, I believe, provide the kind of service to this community that it deserves. I would hate to think that upon my death or the death of one of partners, that it would become necessary to either sell the bank to a multi-bank holding company, or to some independently weathy outside investors. In either case, I do not believe that the best interest of the bank, its customers, and the community,as a whole, would be served.

It seems to me that the present method of reviewing each stock redemption proposal,on its own merits,is far superior to the adoption of arbitrary and restricted guidelines that especially affect the small to medium size bank holding company.

Very truly yours,



Paul Tellefson
President

PT:ba

PHONE (218) 483-3361

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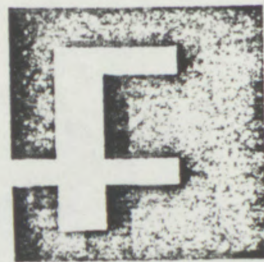
Federal Reserve Bank of St. Louis

FIRST NATIONAL BANK

FERGUS FALLS, MINNESOTA 56537
TELEPHONE, AREA CODE 218·739·4461



JUL 16 1983

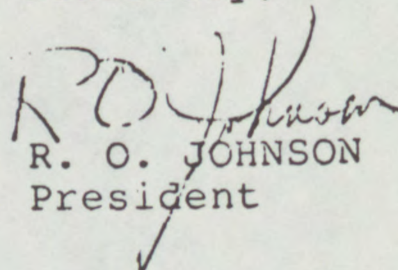
July 14, 1983

Congressman Arlan Stangeland
1526 Longworth Office Building
Washington, D.C. 20515

Dear Congressman Stangeland:

Proposed Regulation Y Section 225.4, Subdivision (b), will have a serious negative impact on our one-bank holding company. I would urge that you utilize your influence with the Baord of Governors of the Federal Reserve System in opposing this change in Regulation Y.

Sincerely,



R. O. JOHNSON
President

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Federal Reserve Bank of St. Louis

Hugo V. Olson
ATTORNEY AT LAW
P.O. Box 617
200 FM Center
Moorhead, Minnesota 56560
(218) 233-1331

JUL 14 1983

July 11, 1983

The Honorable Senator David Durenberger
353 Russell Senate Office Building
Washington, D.C. 20510

The Honorable Senator Rudy Boschwitz
2317 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Representative Arlan Stangeland
1519 Longworth House Office Building
Washington, D.C. 20515

Gentlemen:

The Federal Reserve Board proposes to amend Regulation Y governing bank holding companies and prohibiting them from redeeming their own stock. I enclose a copy of my letter to the board pursuant to its request for comment. Obviously, I am opposed to this proposed amendment and feel it will damage the smaller banks in America.

The majority of the banks in Minnesota are owned by individuals, one or more of whom work in the bank. They are a vital part of small town America and always interested in the welfare of their communities. Banking is not a truly lucrative business and a large part of the profits that are earned must be retained in the bank business to enable the capital base of the bank to grow as deposits grow. Because of a heavy tax load (state and Federal), a load which is much heavier at times on banks than on other institutions, one bank holding companies are used as a vehicle to acquire a bank and payoff acquisition loans through that vehicle. The small corporations of America use the power of stock redemption as a method of enabling them to buy out stockholders who are retiring or wish to sell. It is an excellent estate planning vehicle. The proposed amendment to Regulation Y would deprive small holding companies and owners of small banks of this right.

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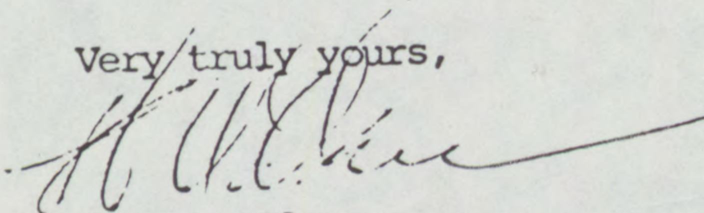
Hugo V. Olson
ATTORNEY AT LAW
P.O. Box 617
200 FM Center
Moorhead, Minnesota 56560
(218) 233-1331

As stated in my letter to the Federal Reserve Board, this will result in a reduction in the value of the stock and limit the number of possible purchasers. It will primarily benefit multi-bank holding companies and eventually concentrate the financial institution in the hands of a few. From my reading it appears the Federal Reserve Board supports an increase in the United States Governments investment in the IMF to enable the IMF to lend money to the worlds developing countries who so happen to be borrowers from the major money center banks. Such loans will, of course, reduce the pressure on the money center banks who have made foreign loans. The Fed appears to want to help the money center banks and limit the small banks in their powers to so conduct their businesses so they can stay in operation in the future as community owned banks.

It is my understanding that the FDIC and Comptroller of the Currency are responsible for supervising the financial lawability of the bank. If dividends are too high the comptroller has guide lines which govern national banks and I am sure that the FDIC has similar rules. Now the Federal Reserve wants to further restrict the use of dividends received by the holding company. This is not a simple matter. I am of the opinion that this, in effect, can have a serious consequence to small banks. I want to tell you that I am Chairman of the Board of a National Bank. I also want you to know that I have entered into an agreement relating to the redemption of my stock which agreement has previously been approved by the Federal Reserve Board. In other words I do not have the financial interest in this matter which I had a year ago. However, I feel very strongly that this is a very bad thing for the banking business and particularily the small banks of America. I would appreciate any help you gentlemen can give in this matter because it seems to me the Federal Reserve is over reaching and attempting to exercise absolute control over the entire banking industry. Most small banks are pretty well managed. If they aren't they have to go out of business. We need a viable small banking system in this country otherwise you are going to have people in the financial control of funds who have no interest in a particular communities future or financial viability.

Very truly yours,



Hugo V. Olson
Attorney at Law

HVO/rf

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Federal Reserve Bank of St. Louis

Hugo V. Olson
ATTORNEY AT LAW
P.O. Box 617
200 FM Center
Moorhead, Minnesota 56560
(218) 233-1331

July 11, 1983

Document R-0470
Federal Reserve Board of Governors
Federal Reserve Bank
Washington, D.C. 20551

Gentlemen:

Your proposal revision of Regulation Y has come to my attention. I am absolutely opposed to the change and think it is dangerous and certainly dilatorious to the banking system of this country. My question at this time in the issue involved is the following: "Is the Federal Reserve Board attempting to limit the possible purchases of banks to multi-bank holding companies?" Most small banks are well capitalized and are owned and controlled by small groups of individuals or by a one bank holding company which is owned or controlled by one or more individuals who are usually members of the business community where the bank is located.

Because of state and federal tax laws it is difficult to accumulate money in the hands of an individual to use to buy a bank. Other businesses or other businesses operating as corporations in the United States have the right and power to redeem their own stock in order to transfer ownership. The boards proposed regulation deprives the small bank holding company of this right. It, in effect, says to the small bank holding company that you cannot operate or redeem stock in the fashion suggested except by paying dividends to your stockholders and paying additional taxes to the various taxing entities. A further effect of your proposals to limit (if not deprive) an individual of his right to own or acquire a bank are the limitations it imposes on his ability to dispose of such bank. It limits the possible purchasers of such bank stock substantially and benefits multi-bank holding companies or money center banks who have the resources to purchase such bank and take its ownership out of the community where it is located.

Again, I want to express my opposition to what the board proposes. I want you to know that I have an interest in a bank. I am Chairman of the Board of The First National Bank of Barnesville. I also want you to know that we have (with the board approval) carried out a partial redemption of my stock. I will eventually be out of the business one way or another but the proposal in my opinion is foolish and, as I have said before, dilatorious to the banking business.

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Hugo V. Olson
ATTORNEY AT LAW
P.O. Box 617
200 FM Center
Moorhead, Minnesota 56560
(218) 233-1331

You now exercise a certain amount of control in requiring that the holding company obtain the consent of the board before redeeming any stock and under those circumstances I do not understand why the board wants the amendment it proposes particularily since there appears to be a serious question as to your legal authority to impose the proposed change.

Very truly yours,

Hugo V. Olson
Attorney at Law

HVO/rf

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MINNESOTA BANKERS ASSOCIATION

332 BAKER BUILDING • MINNEAPOLIS, MINNESOTA 55402

(612) 338-7851

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TRUMAN L. JEFFERS
EXECUTIVE VICE PRESIDENT

WAYNE F. BERTHIAUME
ADMINISTRATIVE VICE PRESIDENT

JOHN S. JACKSON
GENERAL COUNSEL

MARGARET GOFF
INSURANCE DEPARTMENT MANAGER

July 14, 1983

JUL 18 198

The Honorable Arlan Stangeland
1526 Longworth Office Building
Washington, D.C. 20515

Re: Proposed Revision and Update of
Regulation Y

Dear Congressman Stangeland:

The Federal Reserve Board has announced proposed revisions to Regulation Y which will seriously impact private owners of small banks. Your office has no doubt received numerous calls and letters on the issue. It is believed that the proposed regulation will adversely affect private ownership of small banks in that it will seriously limit bank holding companies as estate planning vehicles, limit the continuity of ownership by reducing the marketability of minority interests of privately owned bank holding company stock, as well as adversely affecting employee stock option plans that own such stock.

As a means of acquainting you with the issue, enclosed are comments prepared by a senior consultant with Bankers Resource Center, Inc., a Minneapolis firm.

I believe the comment period with respect to the proposed rule has been extended to August 1. Our office would appreciate whatever assistance you deem appropriate with respect to effecting Board reconsideration of its proposal.

Thank you.

Very truly yours,

John S. Jackson

John S. Jackson
General Counsel

JSJ:jab

Enclosure

cc: Herbert A. Lund
Galen T. Pate

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COMMENTS ON THE PROPOSED REVISIONS TO REGULATION Y

Introduction

The Board of Governors of the Federal Reserve System (hereinafter the "Board") is proposing a change to Regulation Y that does not appear to be authorized by statute and would arbitrarily set a supervisory precedent of potentially far-reaching proportions. Moreover, the new regulation would represent a clear and present threat to the continuation of private ownership of commercial banks. What would appear at first glance to be a rather insignificant change to an existing regulation, will only increase the ease with which the large banking organizations may eventually acquire the small, privately owned banks, leaving only a few megabanks from which the public may seek banking services.

over

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On May 19, 1983, the Board issued a notice of proposed revisions to Regulation Y. This regulation represents the Board's implementation of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 *et seq.*) and the Change in Bank Control Act of 1978 (12 U.S.C. 1817 (j)). The notice states that the proposed revision is part of the Board's program to improve and simplify its regulations. In fact, the summary language used in the notice would lead one to believe that the revisions as proposed are innocuous enough, so that those affected or potentially affected should be in favor of, or not object to, the revisions. This reasoning seems valid except for the amendment being proposed to section 225.6 of Regulation Y entitled "Corporate Practices", which is the subject of this paper.

The Current Regulation

Currently, section 225.6 specifies the notification requirements for a bank holding company (hereinafter "BHC") planning to purchase or redeem its own shares. Essentially, a BHC is required to notify its Federal Reserve Bank at least 45 days prior to a planned purchase or redemption of its own stock if the purchase price is equal to 10 per cent or more of the company's net worth. The only way the Board can prevent such a transaction is through the successful issuance of a cease and desist order, wherein the proposed transaction is deemed to constitute an unsafe or unsound practice, or the transaction would violate an applicable law, rule, regulation or order, or any condition imposed by, or written agreement with, the Board.

The current regulation was implemented in 1976 primarily to prevent excessive releveraging of BHCs in conjunction with a change in control. Often such releveraging effectively circumvented the Board's power to approve or deny BHC formations. The purpose and necessity of this section was diminished with passage of the Change in Bank Control Act of 1978. This law gave the Board direct authority to deny a proposed change in control of an existing BHC, whether or not a stock redemption is involved.

The Proposed Regulation

The proposed revision is under a new section number 225.4, and has two subsections. Subsection (a), entitled "Bank holding company policy and operations", codifies the policy of the Board that a BHC should serve as a source of strength for its subsidiaries and conduct its bank and nonbank operations in accordance with sound banking policy and practice. Also, subsection (a) describes the provision of the Bank Holding Company Act that authorizes the Board to order divestiture of a nonbank subsidiary or activity under certain adverse circumstances. It is not this subsection, but subsection (b) of the new 225.4 that is objectionable.

In subsection (b), entitled, as before, "Purchase or redemption by a bank holding company of its own securities", the prior notification requirements have been replaced by a blanket prohibition on stock redemptions by a BHC, unless it complies with the minimum standards in the Board's policy statement on capital adequacy. Exceptions would be permitted by the Board only in unusual circumstances or if the redemption is *de minimus*. The official language proposed for section 225.4 follows:

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SECTION 225.4 -- CORPORATE PRACTICES

(a) Bank holding company policy and operation. (1) A bank holding company shall serve as a source of financial and managerial strength to its bank subsidiaries and shall conduct all of its operations in accordance with sound banking policy and practice.

(2) Whenever the Board believes an activity or control of a nonbank subsidiary constitutes a serious risk to safety, soundness, or stability of a bank subsidiary of a bank holding company, and is inconsistent with sound banking principles or the purposes of the BHC Act, the Board may require the bank holding company to terminate the activity or to terminate control of the subsidiary, as provided in section 5(e) of the BHC Act.

(b) Purchase or redemption by a bank holding company of its own securities. A bank holding company may not purchase or redeem its equity securities, unless:

(1) the gross consideration paid for the securities, when added to the net consideration[1] paid for all similar transactions during the preceding 12-month period, is not more than $10 million or 1 pecent of the bank holding company's net worth, whichever is less, or

(2) the bank holding company has:

(i) consolidated assets of $1 billion or more, and after the purchase or redemption, its consolidated primary capital-to-assets ratio is at least 5 percent;

(ii) consolidated assets of $150 million to $1 billion, and after the purchase or redemption, its consolidated primary capital-to-total assets ratio is at least 6 percent; or

(iii) total banking assets of $150 million or less, and after the purchase or redemption,

(A) the primary capital-to-total assets ratio of the bank holding company (consolidated) is at least 6 percent or

---

[1] For the purposes of this section, "net consideration" is the gross consideration paid by the company for all of its equity securities purchased or redeemed during the period minus the gross consideration received for all of its equity securities sold during the period other than as part of a new issue.

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(B) the primary capital-to-total assets ratio of each subsidiary bank of the holding company is at least 6 percent and the debt-to-equity ratio of the parent bank holding company (nonconsolidated) is no more than 30 percent; or

(3) the bank holding company obtains the prior approval of the Board for the redemption or purchase on the basis of unusual circumstances.

Objections

From a banker's point of view, there are substantial objections to subsection (b) as proposed. First, there is a serious question as to whether the Board is authorized by law to implement this subsection, which, if issued and upheld, represents a dangerous precedent whereby a federal regulatory agency may prohibit a banking organization from conducting a standard, legal corporate practice unless that organization meets certain standards established by the regulatory agency. Secondly, because of the minimum standards to be imposed by the Board, the proposed regulation will adversely affect private ownership of small banks, in that it will severely limit BHCs as estate planning vehicles and will limit continuity of ownership; it will markedly reduce the marketability of minority interests of privately owned BHC stock; and it will adversely affect or eliminate employee stock option plans (hereinafter "ESOPs") that own BHC stock. This will, of course, place a substantial economic hardship on private owners of small banks, and they will be forced to file new BHC formation applications with the Federal Reserve System as an alternative to a stock redemption. The reasons for arriving at the aforementioned conclusions are set forth in the ensuing paragraphs.

(1) Absence of Statutory Authority

In proposing the new section 225.4, the Board is relying on 12 U.S.C. 1844(b), which refers to Board authority to implement the Bank Holding Company Act of 1956, and 12 U.S.C. 1818(b)(3), which authorizes the Board to issue cease and desist orders against BHCs. Cease and desist orders are primarily issued in response to unsafe or unsound practices, or violations of laws, rules, and regulations. It appears that subsection (a) refers to 12 U.S.C. 1844(b), and subsection (b) refers to 12 U.S.C. 1818(b)(3).

The Board, through the new section 225.4(b), is contending it has the authority to prohibit a standard corporate practice by a BHC if the BHC does not meet certain standards promulgated by the Board. By direct implication, the Board is saying that it considers a stock redemption to be unsafe or unsound whenever a BHC does not meet specified standards as determined by the Board.

Apparently, the Board has used the case law history of the Office of the Comptroller of the Currency (hereinafter "OCC"), wherein the OCC declared that the practice of not retaining certain insurance income in a bank to be unsafe or unsound and issued regulations outlawing such activity. The OCC requires that income earned from the sale of credit life, health, and accident insurance sold in conjunction with the making of loans in a bank must remain in the bank.

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The Board, in its bank supervisory and regulatory capacity, has never before proposed or issued a regulation that bans a legal corporate practice unless specified standards are met. While the Board may contend it is relying on legal support from the case law of the OCC's regulation prohibiting an insurance practice determined to be unsafe or unsound, the Board is not proposing to prohibit a practice considered by it to be unsafe or unsound. To the contrary, the Board wants to prohibit a standard, acceptable corporate practice whenever a certain capital standard, as determined by the Board, is not being met. This is an important distinction to draw between the regulation issued by the OCC and that being proposed by the Board. On this basis alone, the Board should be precluded from issuing the proposed amendment.

(2) Establishes Dangerous Precedent

If the Board succeeds in issuing this amendment, a dangerous precedent will be established as it relates to supervision of banking organizations by the Federal Reserve System and other federal bank regulatory agencies. By not allowing a stock redemption to take place unless minimum capital standards are maintained, the Board is contending in effect that capital of a BHC should not be reduced as a result of a conscious action of BHC management. On the face of it, such a restriction does not appear unreasonable, since a stock redemption reduces capital and financial strength. However, does it not logically follow that the Board may similarly want to prohibit payment of dividends by a BHC unless minimum capital standards are maintained? After all, the payment of dividends also reduces capital. And, if the debt to equity relationship is an issue, the Board could also be expected to prohibit any increase in debt unless minimum capital standards are maintained. Similar prohibitions could also be established to include corporate salaries and other controllable expenses, as well as the structure of assets and liabilities.

In other words, a precedent would be established whereby the Board could prevent a banking organization from conducting its business (i.e. take over management) unless it met specific standards established by the Board. The statutory reference used by the Board in proposing section 225.4(b) does not appear to authorize such outright control over banking organizations. A reasonable thought process must lead one to conclude that if the Board does not have the authority to place outright controls on dividends, debt levels, asset and liability structures, and other management prerogatives, the Board certainly does not have the authority to so restrict stock redemptions.

(3) Minimum Standards are Inconsistent with Policy on Capital Adequacy

Even if one could somehow make a reasonable argument that the Board does have the statutory authority to issue the proposed revision to Regulation Y, the minimum standards imposed by the Board are so restrictive that most typical stock redemptions by a small BHC normally could not take place.

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The Board states in the document issued for public comment that it proposes the following:

> . . . to prohibit a bank holding company from purchasing or redeeming its equity securities, unless, after giving effect to the redemption or acquisition, the bank holding company complies with the minimum standards in the Board's Policy Statement on Capital Adequacy.

Without taking issue with the reasonableness or legal authority of the Board's policy on capital adequacy issued in concert with the OCC, the Board is proposing to incorporate more into the minimum standard for small BHCs (consolidated assets of less than $150 million) than is included in the capital adequacy guidelines. The capital adequacy guidelines issued to each Federal Reserve Bank state, in part, the following:

> <u>Capital Adequacy Guidelines</u>
>
> 1. Application of guidelines. The guidelines program will generally apply to national and State member banks and bank holding companies on a consolidated basis. However, for holding companies under $150 million in consolidated assets, the capital guidelines will apply to the <u>bank</u> <u>only</u>, <u>provided</u>:
>
> (1) the holding company does not engage directly or indirectly in any nonbanking activity involving significant leverage; <u>and</u> (2) no significant debt of the parent is held by the general public. If these conditions are met, the holding company, other things being equal, is less likely to pose additional risks to the bank, and the condition of the bank is generally felt to be separable from the condition of the holding company. Under these conditions, therefore, the holding company for purposes of capital analysis will generally not be consolidated and subject to the imposition of capital guidelines on what are usually lower consolidated ratios.

The guidelines go on to explain that a minimum acceptable capital to assets relationship for a subsidiary bank of a small BHC is 6%. However, the Board apparently realized that their proposed regulatory amendment would be essentially ineffective in prohibiting many significant stock redemptions by small BHCs if only the minimum capital standard for the subsidiary bank were applied. Therefore, the Board added a debt to equity criterion at the parent BHC level, insofar as stock redemptions are concerned. The 30% debt to equity minimum standard, as proposed, is the level that the Board requires for a BHC to demonstrate it can meet by the twelfth year after formation. This is in conjunction with an application filed with the Board to form a BHC.

The relationship of debt to equity, while a factor in analyzing a BHC's overall financial condition, is not explicitly a part of the capital adequacy guidelines issued by the Board as they relate to either small or large BHCs. Many BHCs are considered to be in satisfactory financial condition with debt to equity percentages far in excess of 30%. The Board certainly has not previously intimated that a debt to equity level exceeding 30% is an unsafe

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or unsound condition. If such were the case, many of the BHC applications recently approved by the Board would constitute approvals of BHCs with debt to equity levels considered to be unsafe or unsound, in the context of the proposed revisions. Thus, incorporation of the debt to equity standard appears unreasonable and unwarranted.

In this same vein, the Board has added an alternative standard for a small BHC to meet, which is a consolidated capital to assets relationship of 6%. Such a standard is also not a part of the capital adequacy quidelines for small BHCs. Yet this alternative standard would nevertheless have an effect similar to the debt to equity standard. This is true because a small BHC with significant leverage would not normally be able to meet the 6% consolidated percentage of capital to assets standard, unless its subsidiary bank had a capital ratio substantially in excess of 6%, or even 7%. In fact, if a BHC's subsidiary bank had a 7% capital to assets percentage and the bank stock was being carried at book value by the parent BHC, the BHC's debt to equity position could not exceed 14% without the consolidated capital to assets relationship falling to below 6%. Thus, the incorporation of a 6% consolidated capital to assets ratio for small BHCs as an alternative minimum standard appears unreasonable and unwarranted.

(4) Adverse Effect on Private Ownership of Small Banks

With the highly restrictive minimum standards being proposed by the Board before a stock redemption may be transacted, the new regulation poses a significant threat to private ownership of small banking organizations.

For example, many BHCs are formed for estate planning purposes, wherein controlling ownership by a given family can be more readily continued upon the death of a family member. The BHC normally has the capacity to borrow money to redeem BHC shares owned by the deceased person to pay estate taxes and/or to provide for orderly distribution of estate assets. Larger correspondent banks are usually willing to lend an amount up to 100% of the book value of the subsidiary bank stock owned by the BHC. Also, normally there is very little market for BHC stock owned by minority investors, except for the willingness and capacity of the BHC to purchase such stock. Often, the BHC has ready access to funds by borrowing against its subsidiary bank stock and, unlike most individuals, has the privilege and right as a tax shelter to service the associated debt with pre-tax dollars. In addition, there are many buy-sell agreements, wherein the BHC is contractually obligated to purchase shares of one or more shareholders under certain conditions.

Without the ability to redeem stock, a significant hardship could be placed on continuity of BHC ownership by a given family, and potential marketability of minority interests will be substantially reduced. As to the effect on ESOPs, as an integral part of such programs, ESOPs have a contractual right to put their BHC stock back to the BHC at a predetermined price in relation to book value. Without this put option, the attractiveness of ESOPs buying BHC stock is substantially reduced, since a ready market for the stock does not otherwise exist.

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Conclusion

In revising the stock redemption section of Regulation Y as proposed, the Board would be clearly exceeding its supervisory and regulatory authority over banking organizations and would be contributing to the demise of private ownership of commercial banks.

The banking community must not only understand the implications and consequences of the proposed regulation, it must take immediate and decisive action to prevent issuance of the regulation. The Board very seldom makes material changes to, or recinds, a proposed regulation issued for public comment. Therefore, objections to the proposed regulation must be made on both an individual and national scale, including communication with congressional representatives, especially those on banking committees. Only then will there be a chance to convince the Board not to revise the regulation in question in the unwarranted manner as proposed.

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Cashier

PETER S. GANDRUD
Auditor

WILLIAM HOBERG
Assistant Vice-President

ROBERT M. KILEY
Assistant Cashier

JEANETTE SANDVEN
Pers. Officer

KAREN EVENSON
Loan Officer

July 15, 1983

Congressman Arlan Stangeland
1526 Longworth Office Building
Washinton, D. C. 20515

Re: Docket No. R-0470

Dear Congressman Stangeland:

I am writing you to comment and express my feelings on the proposed revision to Regulation Y being considered by the Federal Reserve Board. I am concerned with Subsection B entitled "Purchase or Redemption by a Bank Holding Company of its Own Securities". I feel the minimum standards to be imposed by the Board will adversely affect private ownership of small banks, in that it will severely limit BHCs as estate planning vehicles and will limit continuity of ownership; it will markedly reduce the marketability of minority interests of privately owned BHC stock; and it will adversely affect or eliminate employee stock option plans.

In our one-bank holding company which is an owner of a small bank, $50,000,000 in deposits, we have no public market for our holding company stock and it would seriously inhibit and limit the market for minority shareholders that own bank holding company stock.

I believe that the regulatory agencies have sufficient authority to regulate capital requirements with banks and to assure safe and sound operation without the authority they are proposing in their revised Reg. Y. I also seriously question as to whether the Board is authorized by law to implement this subsection, which, if issued and upheld, represents a dangerous precedent whereby a federal regulatory agency may prohibit a banking organization from conducting a standard, legal corporate practice unless that organization meets certain standards established by the regulatory agency.

I hope that you will give consideration of my thoughts and do everything possible to prevent this regulatory change.

Sincerely,

[signature]

President

PWG/js

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Lakeland State Bank

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BRANCH OFFICE: CROSSLAKE, MINNESOTA 56442

GLENN S. BIRKELAND, *President*

July 14, 1983 JUL 18 198

Congressman Arlan Stangeland
1526 Longworth Office Building
Washington, D. C. 20515

Dear Congressman Stangeland,

I recently received notice that the Federal Reserve Board is receiving comments on revision of Regulation Y pertaining to the ownership of small banks by one-bank holding companies. I sincerely believe that the change in the regulation, as proposed, would be very detrimental to the small banks in the United States. It is my interpretatinn that the one-bank holding company was implemented to allow small banks to be owned by individuals and allow the transfer of the stock.

I would urge you to work against the change in Regulation Y as now proposed by the Federal Reserve Board. Thank you very much for your cooperation.

Yours very truly,

GSB/mf

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CARVER COUNTY STATE BANK

Chaska, Minnesota 553
Phone 612-448-21

JUL 18 1983

July 11, 1983

ARLAN
THIS REVISION WOULD SHUT US DOWN - DEVASTATING
D. JR.
7-12-83

SECRETARY
Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

DOCKET NO. R-0470

Dear Sir:

I object strongly to the proposed revision of the stock redemption section of Regulation Y. The future of most small town banks would be severely curtailed with the passage of such legislation.

Our small 25 million bank has just completed the holding company transformation, buy-sells are in place, insurance finding purchased and so forth. This procedure is the only vehicle I had as majority stockholder to affect an orderly and economical transfer of ownership over a 10 to 15 year period. The only other solution available to me would have been an outright sale of the bank. I was extremely reluctant to sell to a large outside conglomerate or holding company as our bank had been in our family control for 120 years. I also had to consider my own estate planning and the careers of two other bank officers that participated with me on the holding company formation. Without the present Minnesota holding company rules and regulations I could not have accomplished what had to be done. Hence, I object very strongly to the proposed revision of the stock redemption section of Regulation Y.

Very truly yours,

D. W. DuToit JR.

D. W. DuToit Jr.
Chairman

cc: Bankers Resource Center, Inc.
Bank Holding Company Association of Minnesota

enc.

Member FDIC

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NORTHERN STATE BANK

July 14, 1983

Representative Arlan Stangeland
1519 Longworth House Office Building
Washington, DC 20510

Dear Representative Stangeland:

Small independent banks are faced with total extinction!

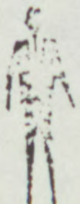
It is bad enough to have the DIDC Committee totally deregulate banks. This is predicted to reduce the number of small banks by as much as 50% in the next few years. However, an even greater threat will most certainly finish off any that are brave enough and lucky enough to survive the foregoing. The Federal Reserve Board is contemplating a rule change which severely restricts the ability of bank holding company shareholders to transfer their stock. I'm enclosing an article from the July 13th issue of the Minneapolis Star and Tribune which very clearly describes our dilemma. It is not an overstatement to say that there will be no small banks left if this goes through. The case cited where one of the bank owners dies is exactly parallel to my own situation. There certainly would be no option available to me but to sell the bank because nobody wants a small share of a privately held bank, as you can understand. Over one-half of the banks in Minnesota are affected by this legislation. This issue is clearly a matter of survival for us. We urgently need your help. Won't you please contact me immediately. The comment period on this is over Monday, July 18th.

Thanks for your help.

Sincerely,

G. A. Beito
President
GAB:pmm

Enclosure



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

PAUL A. VOLCKER
CHAIRMAN

July 29, 1983

The Honorable John Melcher
United States Senate
253 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Melcher:

On January 24, 1983 you wrote to express your concern regarding allegations that had been made against the Helena Branch of the Federal Reserve Bank of Minneapolis by Mr. H. A. Carlson of Capital Aero, Inc., an air courier located in Helena, Montana. You enclosed a letter dated January 13, 1983, in which Mr. Carlson alleged that the Helena Branch had discriminated against Capital Aero (and in favor of the Helena Branch's contract courier) in the application of the Branch's deposit deadline for processing cash letters, and that Helena Branch officials threatened Capital Aero's bank customers with a cut-off of Federal Reserve System business to induce them to switch from Capital Aero to the Branch's contract courier for transportation of checks and other cash items to the Helena Branch.

In a letter dated March 2, 1983, I advised you that I had asked the Board's staff to conduct an examination of Capital Aero's complaint. I regret that because the allegations contained in Mr. Carlson's letter were related to a lawsuit filed by Capital Aero against the Helena Branch, the Board's staff was unable to complete its investigation as expeditiously as it might have otherwise. On June 16, 1983, Capital Aero's suit was dismissed by the United States District Court for the District of Montana (Helena Division) and the Board's staff has now completed its investigation. A copy of the staff's report, which addresses the specific allegations contained in Mr. H. A. Carlson's letter, is enclosed.

The Board staff's investigation included an on-site inspection of the records of the Helena Branch, interviews of the Branch officials involved, and interviews of responsible officers of several of the Montana banks concerned. This investigation revealed that Capital Aero's allegations are not supported, and in significant respects are indeed contradicted, by the available evidence. In fact, Capital Aero apparently

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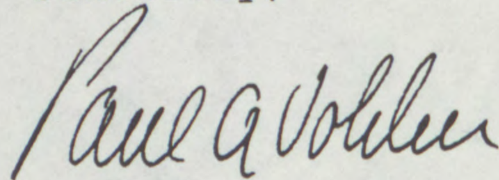
Federal Reserve Bank of St. Louis

received more favorable treatment with respect to the application of the Helena Branch's deposit deadline than the Federal Reserve's chartered air courier, Richland Aviation of Sidney, Montana. In addition, interviews of responsible officers of seven Montana banks, randomly selected from those that switched from Capital Aero to Richland Aviation, disclosed no hint of threats or intimidation of any kind.

Although Capital Aero's allegations have proved to be unfounded, I very much appreciate your bringing even a potential problem to my attention. I can assure you that we will continue to make every effort to assure maintenance of high standards of service in the public interest.

Sincerely,



Enclosure

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Federal Reserve Bank of St. Louis

July 29, 1983

The Honorable Dan Quayle
United States Senate
Washington, D. C. 20510

Dear Senator Quayle:

Thank you for your letter of July 20 recommending Mr. Howard L. Chapman for a position on our Consumer Advisory Council.

I can assure you that Mr. Chapman will receive full consideration when the Board selects eight new Council members later this year.

The Council provides valuable assistance in advising the Board on its implementation of consumer regulations and on other consumer-related matters, and the Board is pleased to receive recommendations for qualified individuals who can contribute to the Council's work.

Again, the Board appreciates having your recommendation.

Sincerely,

S/ Paul

AFC:DJW:vcd (V-147) (83-274)

bcc: Mrs. Bray (w/copy of incoming)
Mrs. Mallardi (2)

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https://fraser.stlouisfed.org
Federal Reserve Bank of St. Louis

DAN QUAYLE
INDIANA

SH 524 HART SENATE OFFICE BUILDING
(202) 224-5623

INDIANAPOLIS OFFICE:
ROOM 447, 46 EAST OHIO STREET
INDIANAPOLIS, INDIANA 46204
(317) 269-5555

United States Senate

WASHINGTON, D.C. 20510

COMMITTEES:
ARMED SERVICES
BUDGET
LABOR AND HUMAN RESOURCES

July 20, 1983

83 274

#147

The Honorable Paul Volcker
Chairman
Board of Governors of the
Federal Reserve Board
Washington, D.C. 20551

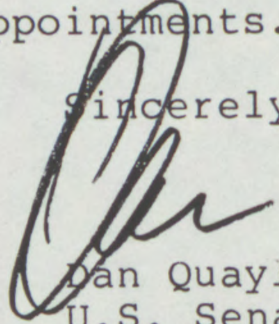
Dear Mr. Chairman:

I am enclosing for your consideration as a nominee to the Consumer Advisory Council of the Federal Reserve Board the resume of Mr. Howard L. Chapman of Fort Wayne, Indiana.

As a practicing attorney in Northeastern Indiana, Mr. Chapman has over 25 years of experience in the field of consumer lending. I am confident that his practical experience in the field would prove to be a real asset to the Consumer Advisory Council. His familiarity with the relevant materials and statutes will permit him to assume the necessary responsibilities with relative ease.

I hope that you will give Mr. Chapman every consideration for one of the eight available appointments to the Board. Please feel free to contact my Administrative Assistant, Tom Duesterberg, if we can provide any additional information or be of any assistance to you. I will look forward to hearing of your decisions on these appointments. Thank you.

Sincerely,



Dan Quayle
U.S. Senator

DQ:tde

Enclosure

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Federal Reserve Bank of St. Louis

Removal Notice

The item(s) identified below have been removed in accordance with FRASER's policy on handling sensitive information in digitization projects due to personally identifiable information.

Citation Information

Document Type: Resume

Number of Pages Removed: 1

Citations: Resume, Howard L. Chapman, 1983.

July 29, 1983

The Honorable Spark Matsunaga
United States Senate
Washington, D. C. 20510

Dear Senator Matsunaga:

Thank you for your letter of July 19 recommending Mr. Lawrence S. Okinaga for a position on our Consumer Advisory Council.

I can assure you that Mr. Okinaga will receive full consideration when the Board selects eight new Council members later this year.

The Council provides valuable assistance in advising the Board on its implementation of consumer regulations and on other consumer-related matters, and the Board is pleased to receive recommendations for qualified individuals who can contribute to the Council's work.

Again, the Board appreciates having your recommendation.

Sincerely,

S/Paul A. Volcker

AFC:DJW:vcd (V-143)

bcc: Mrs. Bray w/copy of incoming
Mrs. Mallardi (2)

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Federal Reserve Bank of St. Louis

SPARK M. MATSUNAGA
HAWAII

WASHINGTON OFFICE:
109 HART BUILDING
WASHINGTON, D.C. 20510

HONOLULU OFFICE:
3104 PRINCE KUHIO BUILDING
HONOLULU, HAWAII 96850

Action assigned Cong. L. Ofc. Mrs. Mallardi

United States Senate

WASHINGTON, D.C. 20510

CHIEF DEPUTY
DEMOCRATIC WHIP

MEMBER:
COMMITTEE ON FINANCE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
COMMITTEE ON LABOR AND HUMAN RESOURCES
COMMITTEE ON VETERANS' AFFAIRS

July 19, 1983

#144 143

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 JUL 25 AM 9:16
RECEIVED
OFFICE OF THE CHAIRMAN

The Honorable Paul Volcker
Chairman
Board of Governors
Federal Reserve System
Washington, D. C. 20551

Dear Mr. Chairman:

It is my understanding that the Governors of the Federal Reserve System are considering nominees to fill eight seats on the Board's Consumer Advisory Council which will become vacant on December 31, 1983. I am writing to bring to your attention a highly qualified candidate from the State of Hawaii, Lawrence S. Okinaga, Esquire.

Mr. Okinaga is a partner in the international law firm of Carlsmith, Carlsmith, Wichman and Case in Honolulu, Hawaii. A native of Hawaii, he is a graduate of the University of Hawaii and received his J. D. degree at Georgetown University Law Center in Washington, D. C. He is a member and Vice Chairman of the Hawaii State Judicial Selection Commission and previously served on the Board of Directors of the Hawaii Bar Association. Despite his busy schedule, Mr. Okinaga has donated his time and legal expertise to many worthwhile community projects. He is a highly respected attorney and civic leader in Honolulu.

I have been very well acquainted with Mr. Okinaga for many years. His personal qualities so impressed me that I asked him to join my congressional staff. Based on his superior job performance and the fine traits that I have observed in him, I recommend his appointment to the Federal Reserve System's Consumer Advisory Council without any reservations whatsoever. He would be a real asset to the Council, and I urge that his application be given early, favorable consideration.

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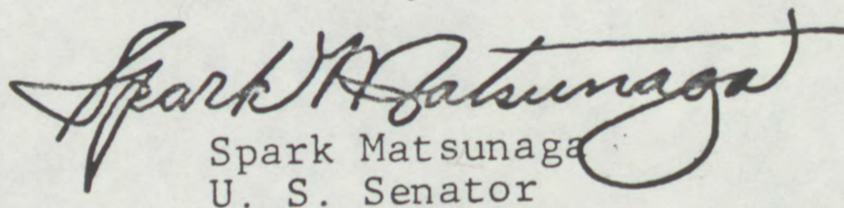
Federal Reserve Bank of St. Louis

A copy of Mr. Okinaga's resume is enclosed for your information.

Aloha and best wishes.

Sincerely,



Spark Matsunaga
U. S. Senator

Enclosure: Resume of Lawrence S. Okinaga

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Removal Notice

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Citation Information

Document Type: Membership application

Number of Pages Removed: 2

Citations: Application for Membership on Consumer Advisory Council, Federal Reserve Board, for Lawrence S. Okinaga, 1983.

Federal Reserve Bank of St. Louis https://fraser.stlouisfed.org

July 29, 1983

The Honorable Richard G. Lugar
United States Senate
Washington, D. C. 20510

Dear Senator Lugar:

Thank you for your letter of July 13 recommending Mr. Howard Chapman for a position on our Consumer Advisory Council.

I can assure you that Mr. Chapman will receive full consideration when the Board selects eight new Council members later this year.

The Council provides valuable assistance in advising the Board on its implementation of consumer regulations and on other consumer-related matters, and the Board is pleased to receive recommendations for qualified individuals who can contribute to the Council's work.

Again, the Board appreciates having your recommendation.

Sincerely,

S/ Paul

AFC:DJW:vcd (V-135)

bcc: Mrs. Bray (w/copy of incoming)
Mrs. Mallardi (2)

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Federal Reserve Bank of St. Louis

RICHARD G. LUGAR
INDIANA

SH 306 SENATE OFFICE BUILDING
WASHINGTON, D.C. 20510
202-224-4814

COMMITTEES:
FOREIGN RELATIONS
AGRICULTURE, NUTRITION AND FORESTRY
SELECT COMMITTEE ON INTELLIGENCE

United States Senate

WASHINGTON, D.C. 20510

July 13, 1983

#135

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 JUL 21 AM 9:00
RECEIVED
OFFICE OF THE CHAIRMAN

Dr. Paul A. Volcker
Chairman
Board of Governors of the Federal Reserve System
Constitution Ave. & 21st Street
Washington, D.C. 20551

Dear Paul:

I understand that Howard Chapman has applied for an appointment to the Consumer Advisory Council to the Federal Reserve.

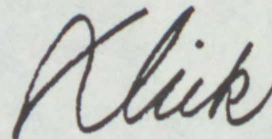
I have known Howard for many years and know that he would make an excellent contribution to this Council. Not only is he an outstanding attorney in Fort Wayne, but he is also very active with the Republican Party. Too, he is very involved with many community activities.

Howard would bring to this advisory council leadership abilities and a solid knowledge of business and consumer-related matters.

Please feel free to contact me if I can provide any additional background or information on behalf of Howard.

I appreciate your serious consideration of his candidacy for a position on the Consumer Advisory Council.

Sincerely,



Richard G. Lugar
United States Senator

RGL:rf

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Federal Reserve Bank of St. Louis

July 29, 1983

The Honorable Paul S. Sarbanes
United States Senate
Washington, D. C. 20510

Dear Senator Sarbanes:

Thank you for your letter of June 29 recommending Ms. Margie H. Muller for a position on our Consumer Advisory Council.

I can assure you that Ms. Muller will receive full consideration when the Board selects eight new Council members later this year.

The Council provides valuable assistance in advising the Board on its implementation of consumer regulations and on other consumer-related matters, and the Board is pleased to receive recommendations for qualified individuals who can contribute to the Council's work.

Again, the Board appreciates having your recommendation.

Sincerely,

S/ Paul

AFC:DJW:vcd (V-117)

bcc: Mrs. Bray (w/copy of incoming)
Mrs. Mallardi (2)

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Federal Reserve Bank of St. Louis

CLO preparing response

PAUL S. SARBANES
MARYLAND

United States Senate
WASHINGTON, D.C. 20510

June 29, 1983 #117

Paul A. Volcker
Chairman
Federal Reserve System
Board of Governors
20th Street & Constitution Avenue, NW
Washington, DC 20551

Dear Mr. Volcker:

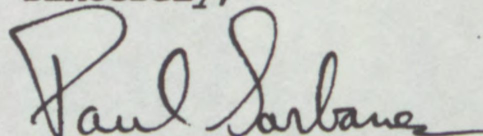
I am writing to recommend highly Margie H. Muller for membership on the Consumer Advisory Council of the Federal Reserve Board.

It has been my pleasure to know Margie Muller for a number of years and to be familiar with her exceptional background in banking and consumer affairs. She has served in very responsible positions in Maryland's major commercial banks and serves as Bank Commissioner in the State of Maryland.

I urge your careful consideration of her qualifications for membership on the Consumer Advisory Council.

With best regards,

Sincerely,



Paul S. Sarbanes
United States Senator

PSS/bmk

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 JUL -1 AM 8:48
RECEIVED
OFFICE OF THE CHAIRMAN

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Federal Reserve Bank of St. Louis

WALTER E. FAUNTROY, D.C., CHAIRMAN

STEPHEN L. NEAL, N.C.
DOUG BARNARD, JR., GA.
CARROLL HUBBARD, JR., KY.
BILL PATMAN, TEX.
BUDDY ROEMER, LA.
BRUCE A. MORRISON, CONN.
JIM COOPER, TENN.
THOMAS R. CARPER, DEL.

GEORGE HANSEN, IDAHO
RON PAUL, TEX.
BILL McCOLLUM, FLA.
BILL LOWERY, CALIF.
JOHN HILER, IND.

H2-109, ANNEX NO. 2
WASHINGTON, D.C. 20515
(202) 226-7315

U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-EIGHTH CONGRESS
WASHINGTON, D.C. 20515

July 28, 1983

The Honorable Paul A. Volcker
Chairman
Board of Governors
Federal Reserve System
20th and Constitution Avenue, N.W.
Washington, D. C. 20551

Dear Paul:

I have received the enclosed letter from my colleague and a Member of the Subcommittee, Mr. Patman on H.R. 1432, a bill to amend the Federal Reserve Act to require the Board of Governors of the Federal Reserve System to transmit to the Congress a monetary early warning report whenever the Board or the FOMC takes any action to implement a change in existing monetary policy.

I have responded to him as shown by the enclosed letter which among other items, states that I would share this letter with you so that you and he could discuss the thrust of the bill at the presently scheduled hearing of this Subcommittee on August 3, 1983. H.R. 1432 is not a part of the hearing for that day; nonetheless, in as much as there is a requirement in both H.R. 1569 and the Chairman's Mark for reporting changes in objectives, I thought it would be useful for us to be able to pursue a colloquy if the opportunity presented itself.

See you then!

With kindest regards, I am

Sincerely yours,

Walter E. Fauntroy
Chairman

ENCLOSURE

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Federal Reserve Bank of St. Louis

HOUSE OF REPRESENTATIVES
WASHINGTON, D. C. 20515

DOUG BARNARD, JR.
10TH DISTRICT OF GEORGIA

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

1983 JUL 29 AM 11:42

RECEIVED
OFFICE OF THE CHAIRMAN

July 27, 1983

Dear Ms. Smith:

It is my understanding that Ms. Mary Jane Large has been nominated by the Consumer Bankers Association for a position on the Federal Reserve Board's Consumer Advisory Council. I am happy to recommend her to you for this position.

During her legal career, Ms. Large has gained an extensive knowledge of consumer laws and regulations as they affect our various financial institutions. Her vast background and experience in the areas of consumer and creditor interests would indeed qualify her as your choice to advise the Federal Reserve's Board of Governors on their responsibilities under the various consumer protection laws.

Ms. Large is sensitive to the need for and importance of the Citizens Advisory Council and would conscientiously and aggressively pursue her duties and responsibilities.

It is my pleasure to recommend her without reservation. Her nomination merits your very serious consideration and approval.

Sincerely,

Ms. Dolores S. Smith
Assistant Director
Division of Consumer and
Community Affairs
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

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Federal Reserve Bank of St. Louis

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

PAUL A. VOLCKER
CHAIRMAN

July 27, 1983

The Honorable Robert H. Michel
House of Representatives
Washington, D.C. 20515

Dear Mr. Michel:

Thank you for your joint letter of July 13 regarding the current course of monetary policy. I feel the best way I can respond to your understandable concerns as a whole is to enclose my recent testimony, pursuant to the Humphrey-Hawkins Act, which deals with the questions in detail.

As I pointed out in that testimony, the Federal Reserve has since May taken a slightly less accommodative posture in the provision of bank reserves. This has been accompanied by--but by no means the sole cause of--some firming in interest rates over this period.

As I hope the testimony makes clear, this action was not taken only, or even primarily, on the basis of strong growth in M1 for several quarters. It was motivated basically by a concern for enhancing the durability of the economic recovery by moving to avoid financial conditions conducive to any resurgence of inflationary pressures. To quote my testimony on this point: "limited, timely and potentially reversible measures now, when the economy is expanding strongly, are clearly preferable to the risks of permitting a situation to develop that would require much more abrupt and forceful action later to deal with new inflationary pressures and a long-sustained pattern of excessive monetary and credit growth."

I also must point out that fiscal policy can relieve pressures on interest rates currently and prospectively by getting excessive federal credit demands out of the way of rising private credit needs to support an expanding private economy. The more rapid expansion of the economy currently, while welcome in itself, also carries the clear potential for advancing the time at which business credit demands will increase strongly, increasing the urgency of reducing the Treasury's call on the market. In that connection, I would note mortgage and consumer financing, as normal at this stage of recovery, has already expanded appreciably more rapidly.

Your recognition of the risks inherent in the current budget situation and your resolve to reduce fiscal pressures--preferably through actions on the expenditure side, but through revenue actions, too, if necessary--can be an enormously constructive influence in the current situation.

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The Honorable Robert H. Michel
Page Two

I should not close without repeating my concern about early passage of the IMF legislation, in major part because failure to support the IMF effort at this critical juncture would carry the grave risk of international financial disarray rebounding back on our own interest rates, the availability of bank credit to Americans, and prospects for sustained recovery.

Sincerely,

S/Paul A. Volcker

Enclosures

NMS:PAV:pjt (#V-129)
bcc: Mrs. Mallardi (2)

Identical letters also sent to: Congressmen Trent Lott, James G. Martin, Philip M. Crane, Jack Kemp, Dick Cheney, and Guy Vander Jagt.

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Federal Reserve Bank of St. Louis

July 27, 1983

The Honorable Bill Patman
House of Representatives
Washington, D.C. 20515

Dear Mr. Patman:

Thank you for your letter of July 12 asking for comment on correspondence from Mr. and Mrs. Edwin Merta of El Campo, Texas, relating to the high cost of credit for housing.

In urging policymakers to consider the effect that interest rates have on the American people, Mr. and Mrs. Merta have focused on a sector of the economy -- housing -- that is particularly sensitive to changes in credit conditions. In this connection, the Federal Reserve through its monetary policy actions has been working for some time to contain inflationary pressures that until quite recently were reflected not only in rising prices of housing and other goods, but also in interest rates that carried a large premium for expected future inflation. I am glad to note that despite some recent increases, costs of mortgage and other types of credit are currently considerably lower than they were only a few years ago when inflation reached double-digit rates.

The likelihood of additional easing in financing conditions for housing during the period ahead hinges importantly, I am convinced, on greater discipline in the government's fiscal affairs. An appropriate reduction in prospective budget deficits would provide an improved environment in financial markets, reduce concerns about future inflation and a further rise in interest rates, and moderate preoccupations that the Federal Reserve might somehow be forced to retreat from its basic anti-inflationary course.

I hope these comments will be helpful.

Sincerely,

S/Paul A. Volcker

RMF:JLK:AFC:NS:pjt (V-130)
bcc: Mr. Fisher
Ms. Wing
Mrs. Mallardi (2)

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Federal Reserve Bank of St. Louis

BILL PATMAN
14TH DISTRICT, TEXAS

Action assigned Jim Kichline Mrs. Mallardi

1408 LONGWORTH BUILDING
WASHINGTON, D.C. 20515
(202) 225-2831

P.O. DRAWER A
GANADO, TEXAS 77962
(512) 771-3303

Congress of the United States
House of Representatives
Washington, D.C. 20515

#130

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
1983 JUL 14 AM 9: 34
RECEIVED OFFICE OF THE CHAIRMAN

July 12, 1983

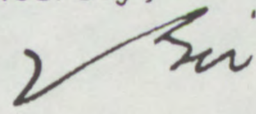
Mr. Paul Volcker
Chairman, Board of Governors
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Mr. Volcker:

Enclosed is a copy of a letter from constituents of mine, Mr. and Mrs. Edwin Merta of El Campo, which they asked me to forward to you. Enclosed with the letter are pages of advertisements for houses from the local paper.

Thank you for your consideration.

Sincerely,



WNP/ac

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Federal Reserve Bank of St. Louis

July 4, 1983

Dear Sir:

We believe, when men allow interest rates (housing) to fluctuate for their own benefit to the detriment of the American family, our country is weakened. A savings and loan company manager said that 50% of the American families cannot afford a house due to high interest rates. An attorney said that couples today need a "guardian angel" when buying a house because of the multiple types of house loans. A realtor told us the escalating loans hurt many couples when their interest rate increases while their income is drained by inflation.

Many persons have been laid off work to look for jobs elsewhere. When they try to sell their house, they run into difficulty because of high interest rates. People are slow to buy when interest is high.

JUL 08 198

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Federal Reserve Bank of St. Louis

In our small town there are a large number of houses on the market. In the June 22, 1983 issue of the "El Campo Leader News," there were 115 houses listed for sale. There are families in need of houses, the middle income families cannot afford to buy when the interest rate is so high. A loan officer at a savings and loan company office told us if the interest rates go up again, they will have many foreclosures because of the escalating loan. When the fixed interest rate dropped below 13%, houses started to sell. We felt this was helping the economy. The interest rate is up to 13% again and people are not looking at houses as they were. When people buy a house they often try harder to keep a job and this leads to buying products for their house. More purchasing means more jobs.

Please encourage persons involved in setting the interest rates to think about the effect rates have on the

American people.

Sincerely
Mr. and Mrs. Edwin J. Merta

P.S.
Enclosed are Ads showing houses for sale
We would appreciate if you would forward this letter and the Ads to Paul Volcker, Chairman of the Federal Reserve. We do not have his address. It seems he needs to be aware of what people like us have to say.

EJM

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Federal Reserve Bank of St. Louis

July 27, 1983

The Honorable Sander Levin
House of Representatives
Washington, D.C. 20515

Dear Mr. Levin:

During the hearing before the House Banking Committee on July 20, Chairman St Germain asked that I respond to the following question from you:

"If there is no action on the fiscal side to reduce the projected deficit, when, in your opinion, is the crisis likely to occur?"

I am pleased to enclose a copy of the response to your question, which I am also forwarding to the Committee for inclusion in the record.

Please let me know if I can be of further assistance.

Sincerely,

S/ Paul

Enclosure (Insert page 118)

CO:pjt
bcc: Mike Prell
Mrs. Mallardi (2)

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Federal Reserve Bank of St. Louis

Insert page 118 (July 20, 1983, hearing before House Banking Committee)

Chairman Volcker subsequently furnished the following in response to a question posed by Congressman Levin:

I don't want to talk in terms of "crises" and I certainly can't pinpoint a crisis date, but I think we can make certain points about the growing risks implied by unabated budget deficits. Even now the call of the Federal Government on the markets adds to interest rate pressures. But we have been able also to say, in the midst of recession, that it has provided purchasing power.

Now, with the economy growing rapidly (particularly consumption), demands for mortgage and consumer credit are picking up. The dangers of a "squeeze" and stronger interest rate pressures will increase--perhaps strongly--when business credit demands also rise sharply. That day will come closer the more rapid the expansion. With a continuing strong expansion, the problems could be apparent toward the end of this year and in 1984--potentially jeopardizing the orderly progress of the economy.

Continued progress against inflation could be one potentially strong counterweight. But what would remain true is abnormally high *real* interest rates, with the risks described.

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Federal Reserve Bank of St. Louis

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

PAUL A. VOLCKER
CHAIRMAN

July 27, 1983

The Honorable Robert H. Michel
House of Representatives
Washington, D.C. 20515

Dear Mr. Michel:

Thank you for your joint letter of July 13 regarding the current course of monetary policy. I feel the best way I can respond to your understandable concerns as a whole is to enclose my recent testimony, pursuant to the Humphrey-Hawkins Act, which deals with the questions in detail.

As I pointed out in that testimony, the Federal Reserve has since May taken a slightly less accommodative posture in the provision of bank reserves. This has been accompanied by--but by no means the sole cause of--some firming in interest rates over this period.

As I hope the testimony makes clear, this action was not taken only, or even primarily, on the basis of strong growth in M1 for several quarters. It was motivated basically by a concern for enhancing the durability of the economic recovery by moving to avoid financial conditions conducive to any resurgence of inflationary pressures. To quote my testimony on this point: "limited, timely and potentially reversible measures now, when the economy is expanding strongly, are clearly preferable to the risks of permitting a situation to develop that would require much more abrupt and forceful action later to deal with new inflationary pressures and a long-sustained pattern of excessive monetary and credit growth."

I also must point out that fiscal policy can relieve pressures on interest rates currently and prospectively by getting excessive federal credit demands out of the way of rising private credit needs to support an expanding private economy. The more rapid expansion of the economy currently, while welcome in itself, also carries the clear potential for advancing the time at which business credit demands will increase strongly, increasing the urgency of reducing the Treasury's call on the market. In that connection, I would note mortgage and consumer financing, as normal at this stage of recovery, has already expanded appreciably more rapidly.

Your recognition of the risks inherent in the current budget situation and your resolve to reduce fiscal pressures--preferably through actions on the expenditure side, but through revenue actions, too, if necessary--can be an enormously constructive influence in the current situation.

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I should not close without repeating my concern about early passage of the IMF legislation, in major part because failure to support the IMF effort at this critical juncture would carry the grave risk of international financial disarray rebounding back on our own interest rates, the availability of bank credit to Americans, and prospects for sustained recovery.

Sincerely,

S/Paul A. Volcker

Enclosures

NMS:PAV:pjt (#V-129)
bcc: Mrs. Mallardi (2)

Identical letters also sent to: Congressmen Trent Lott, James G. Martin, Philip M. Crane, Jack Kemp, Dick Cheney, and Guy Vander Jagt.

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Action assigned to Steve Axilrod

Mrs. Mallardi

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OFFICE OF THE CHAIRMAN

Congress of the United States
House of Representatives
Washington, D.C. 20515

July 13, 1983

#129

Honorable Paul Volcker
Chairman of the Board of Governors
Federal Reserve System
Washington, D.C. 20551

Dear Mr. Chairman,

We are deeply concerned about published reports that the Federal Open Market Committee is seriously considering a tightening of monetary policy and a raising of interest rates. We believe it would be ill-advised for the following reasons.

Concern has focused on the growth of M1 or on the strength of the economic recovery as supposed harbingers of renewed inflation. But we must reject the notion that too much economic growth is the cause of inflation; and in fact the current recovery remains below the post-war norm. Moreover, as you know from the Federal Reserve's recent experience with money supply targets, the M1 definition of the money supply, taken by itself, has been quite misleading as an indicator of monetary policy. Because changes in the demand for money were not adequately anticipated, the kind of upward "nudges" in interest rates and "modest" restrictions of the money supply which are now contemplated became unintentionally contractionary.

Almost every other indicator besides M1 fails to support the wisdom of a rise in interest rates. The dollar has risen and remains quite strong against the strongest foreign currencies. The prices of gold and other sensitive commodities have remained stable if not soft -- indicating the absence of speculation on future inflation. The growth of M3 has slowed over the past eight months, at the same time as M1 accelerated. And even M1 shows recent signs of slowing without a rise in the discount rate.

We pledge our best efforts to bring about reductions in the growth of federal spending which, unlike substantial tax increases, would reduce the total burden of government on the economy. And the economic recovery itself will diminish fiscal pressure by expanding the tax base and diminishing unemployment-related spending.

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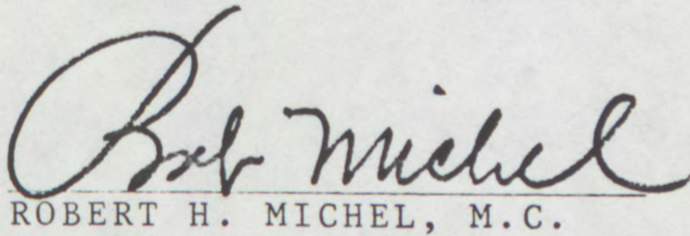
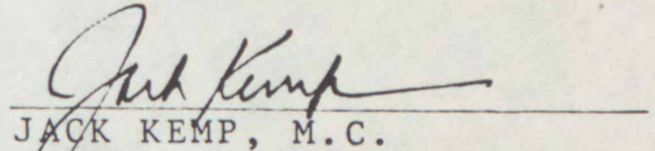
The jobs and hopes of Americans must not be dashed out of abstract concern for one arbitrary measure of the money supply. The current recovery has barely returned the economy in real terms to its 1979 level, and industrial production remains far below it. The recovery must not be needlessly jeopardized by an unnecessary rise in interest rates.

We, and a great many of our colleagues, would look with extreme disfavor upon any increase in the discount or federal funds rates at this time.

Sincerely yours,


ROBERT H. MICHEL, M.C.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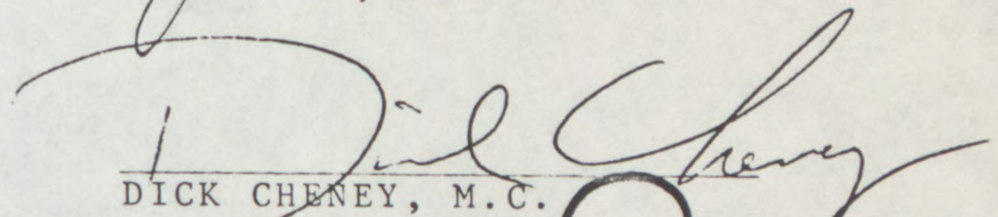
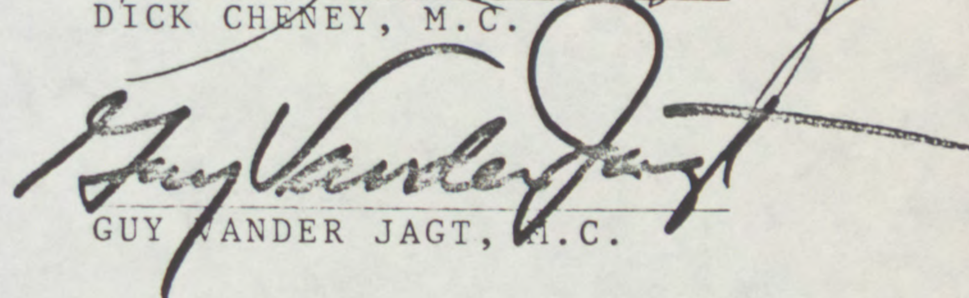
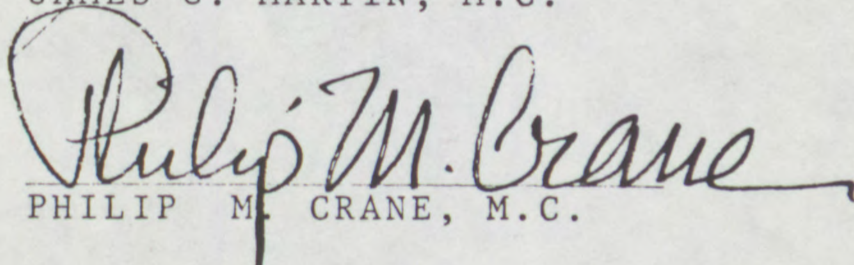
TRENT LOTT, M.C.


DICK CHENEY, M.C.

JAMES G. MARTIN, M.C.


GUY VANDER JAGT, M.C.


PHILIP M. CRANE, M.C.

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BOARD OF GOVERNORS
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WASHINGTON, D. C. 20551

PAUL A. VOLCKER
CHAIRMAN

July 26, 1983

The Honorable Fernand J. St Germain
Chairman
Committee on Banking, Finance
and Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Chairman St Germain:

Several members of Congress have urged that the United States should propose that the International Monetary Fund sell its gold as an alternative to the pending increase in IMF quotas and in commitments to the General Arrangements to Borrow. In support of that position, some of these members have cited my statement in response to a question in February before the Committee on Banking, Finance and Urban Affairs that gold is "an asset of the IMF to help maintain confidence in the institution and make sure it has resources in time of need."

Gold is indeed an asset of the Fund, and it helps to make sure it has resources in time of need. But I believe it is no substitute for the proposed increase in IMF resources before the Congress.

1) Sale of the gold, which provides a contingency reserve for the IMF, in present circumstances would weaken the ability of the IMF to attract other resources through borrowing or otherwise, as it has in the past and will be required to do in the future. Present IMF borrowings were undertaken in the knowledge of lenders that it had substantial gold reserves.

2) Experience demonstrates that gold could not practicably be sold in amounts necessary to meet potential needs, certainly not in the timeframe contemplated.

3) The net result would likely weaken the IMF at a time of maximum strain--a view held strongly by other members, who would have to approve any gold sales, and by the IMF management itself.

Further study of the proper size and form of the "contingency reserve" of the IMF over time, as would be mandated by H.R. 2957, is appropriate. However, for all the reasons cited above, I believe proposals for IMF sale of gold are not a realistic alternative to a quota increase under present circumstances.

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The need now is to strengthen and increase the resources of the IMF, not to weaken its position.

Sincerely,

S/Paul A. Volcker

EMT:PAV:pjt

bcc: Mr. Truman
Mrs. Mallardi (2)

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

July 26, 1983

PAUL A. VOLCKER
CHAIRMAN

The Honorable Walter D. Huddleston
United States Senate
Washington, D.C. 20510

Dear Senator Huddleston:

Thank you for your recent letter in which you expressed concerns that a tightening of monetary policy would abort the current recovery.

Let me assure you that I have no desire to force interest rates higher and interrupt the process of recovery. It is obvious that we need continued expansion to provide jobs for the millions of Americans who are now unemployed and to foster the improved world economy in which many of our trading partners--especially the less developed countries--can work their way out of their current difficulties.

But if we are to achieve these basic objectives, we must be sure that we promote healthy and sustainable growth in the economy, and that means avoiding a new round of inflation. At this point, inflationary forces appear to be fairly well in check, but they will not remain so unless we set and hold monetary and fiscal policies on the right track. The recent firming actions by the Federal Reserve, basically in the form of somewhat less generous provision of reserves to the banking system, were taken against a backdrop of rapid monetary expansion, which, if left unmoderated, would carry real risks of contributing to a reacceleration of prices. Our actions have been cautious and measured--and do not in my view imperil the continued expansion of production and employment.

As you know, interest rates typically have risen as business cycle expansions have progressed. This has not been simply a reflection of "tightening" monetary policy. The dynamics of business upturns generate pressures on credit markets as households and businesses increase their spending. The problem at the present time is that, in contrast to past recoveries, the federal government is not getting out of the way of other borrowers, and so the potential for an early clash of private and public credit demands is serious. Indeed, I think it would be fair to say that interest rates today are higher than they would be if the federal deficits were smaller and the budget were heading convincingly toward balance in the future.

In this context, which recognizes that monetary policy is but one factor shaping interest rates and conditions more

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generally in financial markets and the economy, I welcome your commitment to implementing sound fiscal as well as monetary policies. It is certainly my intention to work with the Congress toward this end in an effort to produce a durable prosperity here and abroad. As we are successful both in dealing with the deficit and keeping inflation under control, I firmly believe that we can look forward to sustained lower interest and long lasting expansion.

Sincerely,

S/Paul A. Volcker

MJP:PAV:pjt (#V-133)
bcc: Mike Prell
Mrs. Mallardi (2)

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WALTER D. HUDDLESTON
KENTUCKY

Action assigned to Mr. Axilrod.

COMMITTEES:
AGRICULTURE, NUTRITION, AND FORESTRY
APPROPRIATIONS
SELECT COMMITTEE ON INTELLIGENCE
SELECT COMMITTEE ON SMALL BUSINESS

United States Senate
WASHINGTON, D.C. 20510

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
1983 JUL 19 PM 12: 32
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July 18, 1983

#133

Honorable Paul A. Volcker
Chairman
Board of Governors
Federal Reserve System
20th and Constitution, NW
Washington, D.C. 20551

Dear Mr. Chairman:

After suffering through the worst recession in forty years there is some hope that we may at last be emerging from the hard times. One of the primary causes of the recession was excessively high interest rates and it was the gradual fall of the rates which has breathed new life into the economic recovery.

The decline of interest rates has generated new activity in the housing industry, and has encouraged families to once again entertain the hope of owning their own home. The decline in interest rates has also sparked new activity in the business sector. Businesses are once again planning for new capital investments and many that have been hanging on by their fingertips have been saved from impending bankruptcy.

Most importantly, declining interest rates have given new hope to the millions of unemployed, many of whom have lost their homes, their savings, and their self-respect.

Unfortunately, it now appears that the Federal Reserve Board is resurrecting its old tight monetary policy, which will once again force interest rates to higher levels. Proof of this is seen in the recent rise in mortgage interest rates and the short-term rates.

I realize that the Federal Reserve believes it has a responsibility to use monetary policy to control inflation and that this has been the driving force behind the Fed's recent action. However, the Fed will be treading on extremely unstable ground if it continues to follow a tight monetary policy, which ignores interest rates, especially at a time when the inflation threat has substantially abated.

Interest rates must be kept down if the economic recovery is to take hold, and they must stay down if the recovery is to continue. I urge you to use your full influence on the Federal Reserve Board to assure that rising interest rates will not choke off recovery from the recession.

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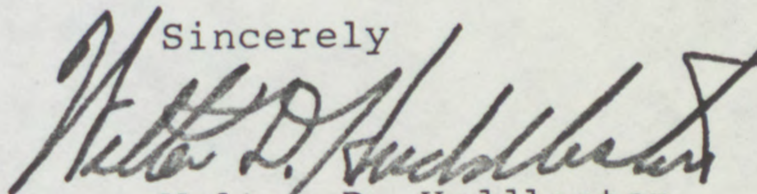
Honorable Paul A. Volcker
July 18, 1983
Page Two

As a member of the Senate, I stand ready to work with you and the President to implement sound and coordinated fiscal and monetary policies, which will bring interest rates down to a level that will unleash the full potential of the American economy.

The budget resolution, recently passed by the Congress, is a step in the right direction. I urge the Federal Reserve Board to give us a chance to go forward with the budget process before shifting gears to a tighter monetary policy. However, if the Fed persists in its policy, and interest rates don't begin to come down, I will actively support all appropriate efforts within the Senate to curb the power of the Fed to pursue this unwise policy.

Sincerely



Walter D. Huddleston

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Federal Reserve Bank of St. Louis

July 25, 1983

The Honorable Fernand J. St Germain
Chairman
Committee on Banking, Finance and
Urban Affairs
House of Representatives
Washington, D. C. 20515

Dear Chairman St Germain:

Pursuant to the requirements of Section 202 of the Cash Discount Act, I am pleased to submit the Board's report on the effect of charge card transactions upon card issuers, merchants, and consumers.

Sincerely,

S/Paul A. Volcker

Enclosure

Identical letters to Cong. Wylie, Chrmn. Annunzio, Cong. Paul
Chrmn. Garn, Sen. Proxmire, Chrmn. Hawkins,
Sen. Dodd

bcc: Bob Fisher
Charles Luckett
Mrs. Mallardi (2)

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July 22, 1983

The Honorable Fernand J. St Germain
Chairman
Committee on Banking, Finance and
Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Chairman St Germain:

I have your letter concerning the "leak" of some or all of the monetary and credit targets, and related information, contained in the Monetary Policy Report to the Congress written here and submitted to your Committee staff during the morning on July 19, preparatory to the hearing on July 20. As you indicate, there are reports that some people in the market or in the press, or both, may have had certain information during July 19. Obviously, this is a matter of great concern to me, as well as to you.

I had already undertaken some preliminary steps to inquire about whether there have been indications of any leak to market participants or whether there was any unusual pattern of market trading on that day that might point to such a leak. I am in the process of reviewing again the internal handling of this material within the Board of Governors and the Federal Open Market Committee during the period since the Open Market Committee meeting.

In the light of our common concern, Mr. Chairman, I would suggest that the most effective and expeditious manner of proceeding would be for us to undertake a joint inquiry with the help of an independent outside party. We want to be mutually satisfied that the matter is resolved and that adequate steps can be taken to minimize any possibility of recurrence.

I would like to have your thoughts in that respect and look forward to hearing from you at your convenience.

Sincerely,

S/ Paul

PAV:pjt (#V-134)
bcc: Mr. Axilrod
Mrs. Mallardi (2)

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STEVE BARTLETT, TEX.

225-4247

July 20, 1983

#134

Honorable Paul Volcker
Chairman
Federal Reserve Board
Washington, D.C. 20551

Dear Mr. Chairman:

As I indicated to you today, I am concerned about the apparent leak of key data from your report prior to the hearing and prior to a general release of the material to the public.

At least one source has suggested that some of the data was in the hands of a "financial house" in New York early Tuesday afternoon. Later either this same data, or data emanating from another source, found its way into the hands of some news media during the afternoon.

Mr. Chairman, I have made a preliminary check of the manner in which the testimony and the report were received from the Federal Reserve and handled by the majority staff of the Committee. This check indicates that there was no distribution, orally or in writing, of any of the data outside the Committee prior to your testimony Wednesday morning. In fact, specific requests for early release of the data and testimony were refused by the staff.

While some may regard the practice as nonsensical, it is a fact that many in the market do indeed base decisions on what they perceive as important clues from these periodic reports and the testimony of the Federal Reserve Chairman. Therefore, a premature release of the data or testimony in any manner to a selected audience--rather than the general public--has the potential for providing some with valuable "inside" information on which to operate in the market.

Neither the Committee nor the Federal Reserve would want the semi-annual reports on monetary policy to become vehicles for such activity and it is in the interests of both of our offices and the public to assure that there is no selective leakage of the data prior to its release to the general public through the hearing process and the full range of the media.

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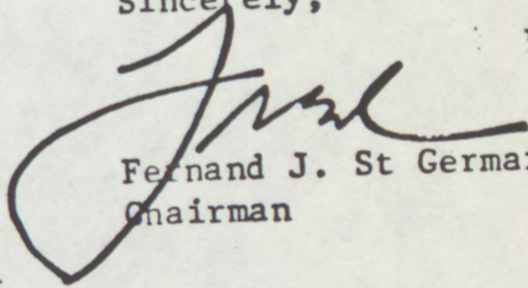
Mr. Chairman, I would appreciate it if you would take a further look into this and attempt to determine to the degree possible how all copies of the data and the testimony were handled within the Federal Reserve and determine, to the degree possible, if there were any leaks from Federal Reserve personnel of this material to any source. The data, of course, was discussed in meetings of the Federal Open Market Committee prior to the preparation of the report and I would want you to review the possibility that the source of the leak could have been from an FOMC source.

I would appreciate a report from you as soon as possible so that these matters may be cleared up in a timely fashion.

Sincerely,



Fernand J. St Germain
Chairman

FJStG:sLs

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July 22, 1983

The Honorable Fernand J. St Germain
Chairman
Committee on Banking, Finance and
Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Chairman St Germain:

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In the light of our common concern, Mr. Chairman, I would suggest that the most effective and expeditious manner of proceeding would be for us to undertake a joint inquiry with the help of an independent outside party. We want to be mutually satisfied that the matter is resolved and that adequate steps can be taken to minimize any possibility of recurrence.

I would like to have your thoughts in that respect and look forward to hearing from you at your convenience.

Sincerely,

S/ Paul

PAV:pjt (#V-134)
bcc: Mr. Axilrod
Mrs. Mallardi (2)

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STEVE BARTLETT, TEX.

225-4247

July 20, 1983

#134

Honorable Paul Volcker
Chairman
Federal Reserve Board
Washington, D.C. 20551

Dear Mr. Chairman:

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Neither the Committee nor the Federal Reserve would want the semi-annual reports on monetary policy to become vehicles for such activity and it is in the interests of both of our offices and the public to assure that there is no selective leakage of the data prior to its release to the general public through the hearing process and the full range of the media.

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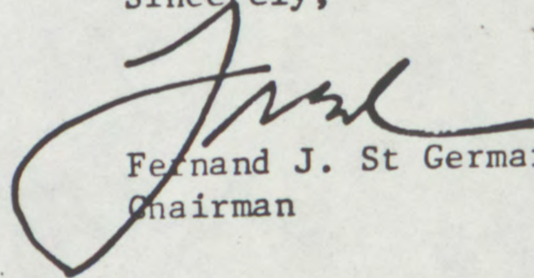

Fernand J. St Germain
Chairman

FJStG:sLs

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

July 21, 1983

PAUL A. VOLCKER
CHAIRMAN

The Honorable Walter E. Fauntroy
Chairman
Subcommittee on Domestic Monetary Policy
Committee on Banking, Finance and
Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Walter:

First, I want to thank you for sending me some weeks ago your remarks to the American Financial Services Association concerning the effects of deregulation on the financial industry. As we have discussed on several occasions, I too am concerned that rapidly evolving changes may have unforeseen consequences upon the continued soundness of the nation's financial institutions. It is appropriate that we proceed cautiously in this area and study carefully the implications of proposed legislation affecting the activities and powers of depository institutions. As you are aware, I have forwarded proposed legislation to Congress that would establish a moratorium on the presently disorderly evolution of the financial system precisely to permit and encourage such careful consideration. I have expressed general support for legislation proposed by the Treasury that would expand the powers of bank holding companies, but only within the framework of adequate supervision of the bank and the entire holding company. There are particular questions in that legislation upon which we will want to comment later. But it is my hope that Congress will take up these issues in the near future so that needed restructuring can proceed in an orderly and thoughtful fashion.

I also appreciated your sending me a copy of your Subcommittee's report on the use of foreign currency obligations as collateral for Federal Reserve notes. I was heartened by your conclusions. In connection with your recommendation that the use of foreign currency obligations be limited to unusual and exigent circumstances, I want you to know we have implemented interim procedures to limit the need to use such obligations. To assure further that the use of such obligations is limited to critical situations, I discussed this matter with the Presidents of the Reserve Banks after the FOMC meeting on Wednesday. I outlined to them the possible options we have for more permanent procedures and received their views on what they perceive as desirable. As a result of these discussions, I have asked staff

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to develop the alternatives further and present them to the Board for consideration shortly. I anticipate that the Board will review this matter in the near future, and I will advise you as to the results.

Again, let me express my appreciation for your comments and support.

Sincerely,

DA:GTS:PAV:pjt (#V-90)
bcc: Don Adams
Gil Schwartz
Mrs. Mallardi (2) ✓
Legal Records (2)

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Federal Reserve Bank of St. Louis

Action assigned Mr. Bradfield; info copy to Mr. Truman

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U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-EIGHTH CONGRESS
WASHINGTON, D.C. 20515

May 18, 1983

#90

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 MAY 20 PM 12: 22
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OFFICE OF THE CHAIRMAN

The Honorable Paul A. Volcker
Chairman
Board of Governors
Federal Reserve System
20th and Constitution Avenue, N.W.
Washington, D. C. 20551

Dear Paul:

On Tuesday, May 17, 1983 I had the opportunity to present opening remarks to the American Financial Services Association's week long convention which starts with Industry Day. I wanted to share those comments with you because they represent much of my current thinking on some very specific issues.

In extending their invitation, AFSA executives asked me to comment upon the impact that deregulation would have upon the financial industry and upon their own unique circumstances. AFSA is a national trade association of 586 companies operating 15,000 offices whose firms are engaged in manufacturing, retailing, banking, thrift operations, and consumer installment lending activities. With such diverse interests, they are very much interested and supportive of deregulation and are much concerned with potential legislation which would further define banks and banking activities particularly as it has been raised in the non-bank banks issue.

Until now, I have not stated any position on the non-bank banks issue. Indeed, I took pains to avoid defining what position I might take on any moratorium or other legislation. I did, however, discuss in some detail my concerns over deregulation and the risks which could rise should we fail to maintain the distinctions we have historically had between banking and commerce. Following delivery of the speech, I decided that I should share it with you and to solicit any further comments that you might have.

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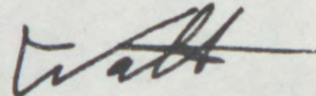
I am also enclosing for your use a copy of the Report of the Subcommittee on the Use of Certain Provisions of the Federal Reserve Act, as amended by Section 105(b)(2) of the Monetary Control Act of 1982 which authorized the Federal Reserve to invest in obligations of, or fully guaranteed as to principal and interest by, a foreign government or agency thereof.

This Report is an outgrowth of a hearing and Subcommittee investigations. Specifically, it states that this provision aids in the more efficient management of Federal Reserve assets, that the Federal Reserve has exercised this authority in a manner consistent with their role, and that there is no credible evidence of a broader use of this authority to monetize foreign debts.

The report also makes certain recommendations on the use of foreign currency assets as collateral and directs the staff to prepare legislation that would abolish the collateral requirement. A copy of that bill, and a statement in support thereof, is also included for your use.

Sincerely yours,



Walter E. Fauntroy
Chairman

ENCLOSURES

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REMARKS OF THE HONORABLE WALTER E. FAUNTROY
CHAIRMAN, SUBCOMMITTEE ON DOMESTIC MONETARY POLICY
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

before the
AMERICAN FINANCIAL SERVICES ASSOCIATION

Hotel Sheraton Washington, Washington D. C.
Tuesday, May 17, 1983

****

It gives me great personal pleasure to welcome each of you to Washington for the Convention of the American Financial Services Association. I am particularly pleased to have the opportunity to be here because of my respect for the work that your association and its members have done on Capitol Hill in banking and finance, in community service, and political activism. Your representatives in Washington work hard; they are knowledgeable; and, more importantly to those of us who are Members of Congress, they have been genuinely helpful.

In extending this invitation, your executives asked me to make a few comments about the impact that deregulation will have upon the financial industry, and upon your own institutions. While I do not propose to become embroiled in the debate over non-bank banks vs. banks, I do want to share with you some of the underlying concerns that make this issue so very difficult for public policy makers.

Deregulation has become something of a religion in Washington. We have deregulated the airlines industry, are beginning to deregulate the trucking, rail, and telecommunications industries, and are trying to catch-up with deregulation in financial services. There is much that is good about this. Old and obsolete practices and prices have been cleared away, efficiency has been improved, and new services have been offered to the public. But we must recognize that there have also been costs: the communities who have lost regular and affordable air service; the people who will lose low cost local phone service; and borrowers who have lost the possibility of low-interest, long-term credit from stable and financially sound institutions.

Very simply, what concerns public policy makers like myself about financial services deregulation are the safety and soundness of depositor funds and whether they will be jeopardized by the adventures of the depository institutions. We have seen over the past years the difficulties which retailers, manufacturers, and developers have gotten into. The question arises, therefore, as to whether the holding companies might be tempted, if the opportunity presented itself, to use the resources of a depository institution to prop up failing affiliates, with consequent risks to the saving public. It is a question which constantly rises; but, in this instance it is more sharply focused because, for the first time, we are confronted with the issue of whether or not we ought to maintain distinctions between banking and commerce.

This issue is critically important because of the role banking and

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financial services play in commerce. Credit is quite literally the lifeblood of our modern economy, whether it be the long-term bonds which businesses need to build plants and equipment or governments need to build highways and airports and water projects, or the mortgages which people need to buy homes, or the loans which businesses need to finance inventories and consumers need to finance purchases.

There are two reasons, therefore, that we in Congress must balance the distinctions between financial services and commerce, and why we must be careful in how we proceed with deregulation of financial services. First, if people lose confidence in our financial system because of the misadventures of financial service institutions, the flow of savings and investments into those institutions will dry up, and our whole economy will stumble. In no other industry would such a loss of confidence have such detrimental effects on the economy. To appreciate this, remember that, before we established national financial regulation in the 1930s, every major economic slump in this country, including the Great Depression, began with a financial collapse.

Second, banking and financial services have become one of the key regulators of economic activity, growth and inflation. Controlling the growth of money and credit has been and will continue to be one of the major ways that we seek to avoid excessive and inflationary booms and harsh recessionary busts. There is strong evidence that financial innovation and deregulation has already made that task harder, with consequent costs for the economy. If we proceed to total deregulation of financial services, we will lose even this governor on excessive economic swings, and revert to the terrible boom-and-bust cycles we had up through the Great Depression. We can offset the effects of deregulation somewhat by, as I have proposed in legislation, shifting the targets of monetary policy from arbitrary monetary and credit aggregates to economic growth. But, for monetary restraint or stimulus to have an even and uniform on the economy, we must assure that the Federal Reserve has potential influence over growth in all parts of financial services. This cannot occur if the lines between finances and commerce become too blurred unless we are willing to accept a more managed economy with centralized planning, federal controls over business activity, credit arrangments, and risk managment including controls over profits, and compensation. I am not at all sure such a scheme is better than the one we presently have; in some very large measure, however, it is one which your industry will have decide for all of us -- not just for yourselves.

As you ponder and discuss the questions of state financial supervisory regulation, dual businesses and regulation, banks vs. non-bank banks, deposit taking powers and regulation today, I hope that you will keep these issues in mind. Your industry is uniquely situated on the borderline between commerce and banking, and where you go will have implications for the whole financial services industry.

Let me conclude, however, by expressing the hope that you will not spend <u>all</u> your time pondering and discussing these issues. I hope that you will also take the time to get out and see this great city of ours, with its magnificent cultural, historical, and public landmarks. Washington, D.C. is my hometown, and I want you to share some of my pleasure and delight in what it has to offer to those of us who live here everyday.

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OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-EIGHTH CONGRESS
WASHINGTON, D.C. 20515

May 20, 1983

Dear Colleague:

A number of you have raised questions concerning the use of those provisions of the Monetary Control Act of 1980 which authorizes the Federal Reserve to "invest in obligations of, or fully guaranteed as to principal and interest by, a foreign government or agency thereof,..."

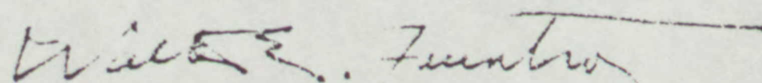
As Chairman of the Subcommittee on Domestic Monetary Policy (which has jurisdiction over the Federal Reserve), I directed that the Subcommittee exercise its oversight authority to ascertain the use of this provision, to weigh the actual benefits of this provision against potential abuse, to provide further guidance to the Federal Reserve in the continued use of this authority, and to consider whether any additional amendments would be necessary or appropriate.

This is the Report of the Subcommittee on these matters which has been prepared under my direction. Specifically, this Report states that this provision aids in the more efficient management of Federal Reserve assets and that the Federal Reserve has exercised this authority in a manner consistent with this role. The Report finds no credible evidence of a broader use of this authority to monetize foreign debts as has been alleged, and no sign of any abuse in its use.

This Report recommends that the use of foreign currency assets as collateral for Federal Reserve Notes be governed by more stringent guidelines to be set by the FOMC so as to limit the practice to unusual and exigent circumstances as long as a collateral requirement is maintained. The Report further recommends that consideration be given to the abolition of this collateral requirement and directs the staff to draft legislation towards that end.

Since the preparation of this Report, I have introduced H.R. 2850, a bill to amend the Federal Reserve Act to provide flexibility in the issuance of Federal Reserve notes in order to assure that the Nation will have an adequate supply of currency. Therefore, in addition to the Report, I have included a copy of the bill, a section-by-section analysis, and a Ramseyer showing changes which would be made to existing law by H.R. 2850. I commend these materials to your reading and urge that you contact the Subcommittee for such additional information as you might need to meet the inquiries of your constituents.

Sincerely yours,



Walter E. Fauntroy
Chairman, Subcommittee on
Domestic Monetary Policy

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REMARKS OF THE HONORABLE WALTER E. FAUNTROY
ON H.R. 2850, FEDERAL RESERVE COLLATERALIZATION
In The House of Representatives
Thursday, May 19, 1983

Mr. Speaker. I am pleased to have introduced H.R. 2850, a bill to amend the Federal Reserve Act to provide flexibility in the issuance of Federal Reserve notes in order to assure that the nation will at all times have an adequate supply of currency by eliminating the present requirement that Federal Reserve notes be collateralized.

Members may recall that hearings were recently held by the Subcommittee on Domestic Monetary Policy on the use of certain provisions of the Federal Reserve Act as amended by section 105(b)(2) of the Monetary Control Act of 1980 which authorized the Federal Reserve to invest "in obligations of, or fully guaranteed as to principal and interest by, a foreign government or agency thereof,..." One of the issues which the Subcommittee explored in connection with the acquisition of foreign obligations was the use of foreign currency assets as collateral for Federal Reserve notes.

All Federal Reserve notes are first and paramount liens on all assets of the Federal Reserve Bank that issued them and are obligations of the United States aside from any collateral which may lie behind them. The Subcommittee discovered that the System as a whole has always had adequate collateral of such form as to eliminate the need for the use of foreign currency assets. However, the distribution of the collateral among the banks is not necessarily in proportion to their note liabilities, which may be dependent upon seasonal and other fluctuations in demands for currency. Intermittent use of acquired foreign securities as collateral for these disproportional currency demands can avoid the cost and inconvenience of inter-Reserve Bank exchanges of other assets.

To date, four Federal Reserve Banks have used foreign currency assets as collateral on various occasions. This use of foreign currency assets is a purely technical phenomenon intended to facilitate the use as collateral of all Federal Reserve System assets in the most economical and orderly manner.

These cases, nonetheless, point to the difficulties of assuring adequate collateral for Federal Reserve Bank issues of currency in response to fluctuating public demand. Such difficulties are so far minor and easily surmountable, but they have a potential to become more serious. People place their money in savings and checking accounts with the confident expectation that these balances can be converted to currency at any time. However, if people's desire to convert savings and checking balances into currency is unexpectedly strong, insufficient collateral could mean the Federal Reserve System would be technically unable to provide enough currency to meet public demand. Such a shortage of currency could have severe adverse consequences for the public's confidence in the financial system. Indeed, this possibility will become greater as the reduction in reserve requirements progresses.

Further changes in collateralization requirements are, therefore, needed. Indeed, it now makes sense to abolish the collateral requirement, which is an anachronism that is no longer appropriate or necessary.

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98TH CONGRESS
1ST SESSION

H. R. 2850

To amend the Federal Reserve Act to provide flexibility in the issuance of Federal Reserve notes in order to assure that the Nation will have an adequate supply of currency.

IN THE HOUSE OF REPRESENTATIVES

MAY 2, 1983

Mr. FAUNTROY introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

---

A BILL

To amend the Federal Reserve Act to provide flexibility in the issuance of Federal Reserve notes in order to assure that the Nation will have an adequate supply of currency.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) the second paragraph of section 16 of the Federal
4 Reserve Act (12 U.S.C. 412) is amended by striking out all
5 that follows the first sentence and inserting in lieu thereof the
6 following: "Collateral shall not be required for Federal Re-
7 serve notes.".
8 (b) The first sentence of the fourth paragraph of section
9 16 of the Federal Reserve Act (12 U.S.C. 414) is amended

1 by striking out "less the amount of gold certificates held by
2 the Federal Reserve agent as collateral security.".
3 (c) The first sentence of the sixth paragraph of section
4 16 of the Federal Reserve Act (12 U.S.C. 416) is hereby
5 repealed.

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SECTION-BY-SECTION ANALYSIS

H.R. 2850 : a bill to provide flexibility in the issuance of Federal Reserve notes to assure that the nation will have an adequate supply of currency.

(a) amends Section 16, paragraph 2, of the Federal Reserve Act (12 USC 412) by striking all text following the first sentence and inserting in lieu thereof the following words: "Collateral shall not be required for Federal Reserve notes."

eliminates the collateral requirement by striking out the requirement that the Federal Reserve set aside collateral equal to the amount/sum of Federal Reserve notes issued and the specifications of what can be used as collateral. Inserted in place of this is a simple statement that collateral is no longer required for Federal Reserve notes.

(b) amends Section 16, paragraph 4, by striking the words "less the amount of gold certificates held by the Federal Reserve agent as collateral security" and inserting in lieu thereof a period.

Section 2 is a technical amendment to conform this provision to the elimination of the collateral requirement. As collateral would no longer be required, the need for gold certificates as collateral security would likewise be eliminated.

(c) amends Section 16, paragraph 6, by striking the first sentence.

Because collateral has been eliminated, this provision becomes redundant and thus, the provision in Section 16, paragraph 6 (the sentence referring to the withdrawal of the substitution provision for collateral with local Federal Reserve agents) has been eliminated. It is no longer necessary to have the sentence because collateral is not required and therefore a substitute for collateral would not be needed.

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SECTION 16 -- NOTE ISSUES

1. Issuance of Federal Reserve Notes; Nature of Obligation; Where Redeemable

Federal reserve notes, to be issued at the discretion of the Board of Governors of the Federal Reserve System for the purpose of making advances to Federal reserve banks through the Federal reserve agents as hereinafter set forth and for no other purpose, are hereby authorized. The said notes shall be obligations of the United States and shall be receivable by all national and member banks and Federal reserve banks and for all taxes, customs, and other public dues. They shall be redeemed in lawful money on demand at the Treasury Department of the United States, in the city of Washington, District of Columbia, or at any Federal Reserve bank.

2. Application for Notes by Federal Reserve Banks

Any Federal Reserve bank may make application to the local Federal Reserve agent for such amount of the Federal Reserve notes hereinbefore provided for as it may require. ~~Such-application-shall be-accompanied-with-a-tender-to-the-local-Federal-Reserve-agent-of collateral-in-amount-equal-to-the-sum-of-the-Federal-Reserve-notes thus-applied-for-and-issued-pursuant-to-such-application.--The collateral-security-thus-offered-shall-be-notes,-drafts,-bills-of exchange,-or-acceptances-acquired-under-the-provisions-of-section-13 of-this-Act,-or-bills-of-exchange-endorsed-by-a-member-bank-of-any Federal-Reserve-district-and-purchased-under-the-provisions-of-section 14-of-this-Act,-or-bankers'-acceptances-purchased-under-the-provisions of-said-section-14,-or-gold-certificates,-or-Special-Drawing-Right certificates,-or-any-obligations-which-are-direct-obligations-of,-or are-fully-guaranteed-as-to-principal-and-interest-by,-the-United States-or-any-agency-thereof-or-assets-that-Federal-Reserve-banks-may purchase-or-hold-under-section-14-of-this-Act.--In-no-event-shall-such collateral-security-be-less-than-the-amount-of-Federal-Reserve-notes applied-for.--The-Federal-Reserve-agent-shall-each-day-notify-the Board-of-Governors-of-the-Federal-Reserve-System-of-all-issues-and withdrawals-of-Federal-Reserve-notes-to-and-by-the-Federal-Reserve bank-to-which-he-is-accredited.--The-said-Board-of-Governors-of-the Federal-Reserve-System-may-at-any-time-call-upon-a-Federal-Reserve bank-for-additional-security-to-protect-the-Federal-Reserve-notes issued-to-it.--Collateral-shall-not-be-required-for-Federal-Reserve notes-which-are-held-in-the-vaults-of-Federal-Reserve-banks.~~ Collateral shall not be required for Federal Reserve notes.

3. Distinctive Letter on Notes; Destruction of Unfit Notes

Federal Reserve notes shall bear upon their faces a distinctive letter and serial number which shall be assigned by the Board of Governors of the Federal Reserve System to each Federal Reserve bank. Federal Reserve notes unfit for circulation shall be canceled, destroyed, and accounted for under procedures prescribed and at locations designated by the Secretary of the Treasury. Upon destruction of such notes, credit with respect thereto shall be apportioned among the twelve Federal Reserve banks as determined by the Board of Governors of the Federal Reserve System.

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4. Granting Right to Issue Notes

The Board of Governors of the Federal Reserve System shall have the right, acting through the Federal Reserve agent, to grant in whole or in part, or to reject entirely the application of any Federal Reserve bank for Federal Reserve notes; but to the extent that such application may be granted the Board of Governors of the Federal Reserve System shall, through its local Federal Reserve agent, supply Federal Reserve notes to the banks so applying, and such bank shall be charged with the amount of the notes issued to it and shall pay such rate of interest as may be established by the Board of Governors of the Federal Reserve System on only that amount of such notes which equals the total amount of its outstanding Federal Reserve notes ~~less-the-amount-of-gold-certificates-held-by-the-Federal Reserve-agent--as-collateral-security~~. Federal Reserve notes issued to any such bank shall, upon delivery, together with such notes of such Federal Reserve bank as may be issued under section 18 of this Act upon security of United States 2 per centum Government bonds, become a first and paramount lien on all the assets of such bank.

5. Deposit to Reduce Liability for Outstanding Notes

Any Federal Reserve bank may at any time reduce its liability for outstanding Federal Reserve notes by depositing with the Federal Reserve agent its Federal Reserve notes, gold certificates, Special Drawing Right certificates, or lawful money of the United States. Federal Reserve notes so deposited shall not be reissued, except upon compliance with the conditions of an original issue. The liability of a Federal Reserve bank with respect to its outstanding Federal Reserve notes shall be reduced by any amount paid by such bank to the Secretary of the Treasury under section 4 of the Old Series Currency Adjustment Act.

6. Substitution of Collateral; Retirement of Federal Reserve Notes

~~Any-Federal-reserve-bank-may-at-its-discretion-withdraw-collateral deposited-with-the-local-Federal-reserve-agent-for-the-protection of-its-Federal-reserve-notes-issed-to-it-and-shall-at-the-same-time substitute-therefor-other-collateral-of-equal-amount-with-the-approval of-the-Federal-reserve-agent-under-regulations-to-be-prescribed-by-the Board-of-Governors-of-the-Federal-Reserve-System.~~ Any Federal reserve bank may retire any of its Federal reserve notes by depositing them with the Federal reserve agent or with the Treasurer of the United States, and such Federal reserve bank shall thereupon be entitled to receive back the collateral deposited with the Federal reserve agent for the security of such notes. Any Federal Reserve bank shall further be entitled to receive back the collateral deposited with the Federal Reserve agent for the security of any notes with respect to which such bank has made payment to the Secretary of the Treasury under section 4 of the Old Series Currency adjustment Act. Federal reserve notes so deposited shall not be reissued except upon compliance with the conditions of an original issue.

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

PAUL A. VOLCKER
CHAIRMAN

July 20, 1983

The Honorable Bill McCollum
House of Representatives
Washington, D. C. 20515

Dear Bill:

I could not resist sending you the attached table showing estimates of the IMF's use of the U.S. quota over the past 30 years. As you can see, in 14 of those years the United States received net repayments from the IMF.

Sincerely,

Paul

Attachment

bcc: Mr. Truman
Mrs. Mallardi (2)

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Estimates of IMF Drawings (-)
and Repayments (+) of U.S. Quota Subscription
(millions of dollars)

Calendar Years

Year	Amount
1953	+ 90
1954	+ 53
1955	+ 150
1956	- 57
1957	- 37
1958	+ 20
1959	- 6
1960	+ 450
1961	- 140
1962	+ 630
1963	+ 20
1964	+ 270
1965	+ 170
1966	+ 296
1967	- 90
1968	- 870
1969	-1,030

Fiscal Years

Year	Amount
1970	- 800
1971	+ 910
1972	+ 990
1973	- 50
1974	- 470
1975	-1,070
1976	-1,205
1977*	- 810
1978	+ 960
1979	+1,330
1980	- 410
1981	-2,360
1982	-1,825

*Includes transitional quarter

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July 20, 1983

The Honorable Paul S. Trible, Jr.
United States Senate
Washington, D.C. 20510

Dear Senator Trible:

Enclosed are my responses to the questions you submitted at my confirmation hearing last week. I have also furnished a copy of my responses to the Committee for inclusion in the record of the hearing.

Sincerely,

Enclosure

AFC:pjt
bcc: Mr. Axilrod
Mr. Truman
Mrs. Mallardi (2)

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In February before this committee, you stated that "over time the growth of money and credit will need to be reduced to encourage a return to reasonable price stability." You also said that financial stability "will require that we avoid excessive growth of money and credit because, sooner or later, that growth will be the enemy of the lower interest rates and stability we need."

How do those statements square with Fed policy which allowed M1 to grow 12.2 percent during the year ending in May, and now has M1 way above its target?

Recent institutional and behavioral changes have made it even more important to look at the behavior of money and credit aggregates as a group in assessing whether their growth rates are consistent with a return to reasonable price stability. Growth rates of M2, M3, and domestic nonfinancial debt are all consistent with their ranges, though their growth has picked up somewhat recently.

M1 is the only aggregate whose growth has run well above target. This has been accepted because of several factors. Looking at M1 itself, there has been continuation into this year of the very unusual, large decline in its velocity that developed last year. This decline in velocity, which may be abating now, appears to be related at least in part to the fact that NOW accounts--in effect interest-bearing checking accounts introduced on a nationwide basis at the beginning of 1981--have come to be an important component of that aggregate. As market rates declined sharply last year, the spread between interest rates available on NOW accounts and other outlets for liquid funds narrowed more than proportionately, apparently stimulating demand (with a lag) for NOW accounts relative to income.

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Other factors may also have been important for a time, including the high degree of economic and financial uncertainty. You will recall that, because of these reasons, we indicated in our earlier testimony less emphasis would, for a time, be placed on M1 alone, and that the judgments about movements in the aggregate would need to be tempered by analysis of business and financial developments generally.

While the underlying trend in M1 may be shifting, that should be a more gradual process. We indeed should be alert to the probability that, cyclically, sizable increases in M1 "velocity," more in accord with historical experience, are likely. Consequently, we look toward substantial slowing of the recent rate of increase in the targets we will be presenting.

Taking account of the aggregates as a whole and institutional changes, I believe we are on a course consistent with encouraging a return to price stability over time--and we must remain so. The weight placed on M1 in particular will be reviewed regularly.

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Since early May, long term interest rates have headed upward. Do you think that rapid money growth, and the failure to keep all money measures within their target ranges, has contributed to this by worsening inflationary expectations and creating uncertainty about what the Fed is up to?

I believe the recent rise in long-term rates reflects several factors. To help assure that growth in money and credit will remain consistent with progress toward price stability, in an environment of accelerated real economic growth, the posture of monetary policy has been slightly less accommodative in recent months; in other words, pressure on bank reserve positions has been increased to a degree. This in itself has been accompanied by some rise in money market rates, which often gives rise to some temporary sympathetic response in longer-term rates. The recent rise in long rates also appears to reflect the impact of the acceleration in economic recovery on actual credit demands, which were appreciable in the second quarter, and anticipation of further increases in the future. The potential conflict with continuing, large federal credit demands is, of course, a matter of great concern, and the speed of the economic recovery has tended to advance those concerns.

I do not exclude some influence from anticipations that more rapid monetary growth might induce _further_ Federal Reserve actions to restrain money and credit growth. As that implies, in an expanding economy with heavy Treasury deficits, action to restrain money growth tends to increase market pressures, even though, in the long run, the effects on inflation

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and interest rates may be favorable. I also agree that considerable skepticism remains about the inflation outlook, but I would not single out recent growth in the aggregates as the principal or major source of new concerns.

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Recent newspaper reports say that Administration officials want the Federal Reserve to restrain monetary growth through open market operations, but not by raising the discount rate. Do you agree with that advice?

Whether the Federal Reserve should raise the discount rate in the process of restraining money growth depends on many factors, such as probable "announcement" effects on attitudes in domestic and international financial markets as well as the more routine problems connected with effective administration of the discount window. But, basically, it depends on an assessment of whether a strong surge in demand for credit at the discount window by depository institutions, given the relation of the discount rate to market rates, is itself fueling excessive monetary expansion. If it is, the restraint on money growth from holding back on provision of reserves through open market operations--which is the fundamental means of controlling money--may need to be reinforced by discount rate action. That is a judgment that can be made only in the context of particular circumstances, taking account of overall economic and financial conditions. In most instances, over time, the tools are complementary.

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What role does the international debt situation play in the Fed's reluctance to slow the growth of money and credit?

I have pointed to the debt problems of many countries in the developing world as one of the major threats to financial stability and to a healthy recovery of the U.S. and world economy. These problems are among the many factors that the FOMC takes into account in reaching decisions on the implementation of monetary policy. In the short run, increases in interest rates from any source or any slowing of economic growth does tend to complicate the problems of international finance, and that factor has been weighed by members of the Committee. Over time, however, I believe lower interest rates and sustained growth will depend upon success in containing inflation, and that consideration is a major element in policy.

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Do you conceive of rapid money growth in the United States as a way to alleviate international debt problems?

No. The ultimate resolution of the serious international debt problems confronting the world economy today will depend in part on achieving a sustained, non-inflationary expansion of the U.S. economy. The contribution that U.S. monetary policy can make to such an expansion is to ensure that progress against inflation is consolidated and extended, which will require restraint on the growth of money and credit over time. In this context, rapid monetary growth in the United States would not long alleviate international debt problems. Indeed, excessive growth would ultimately exacerbate those problems if it were to contribute to a rekindling of U.S. inflation.

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A number of suggestions have been made that there should be an independent audit of the Federal Reserve's finances and policies.

Would you support such an audit? Or is it unnecessary or redundant?

I believe that there are an adequate number of audits of the Federal Reserve. The System is already reviewed at several levels. An independent outside public accounting firm reviews the financial statements of the Board in accordance with generally accepted auditing standards. In addition, the U.S. General Accounting Office performs numerous audits of the Board and the Reserve Banks. These audits include reviews of various programs of the System including activities in the supervisory, consumer and pricing areas. In particular areas, such as "priced services" we ourselves have sometimes initiated independent reviews.

The Board also conducts annual examinations of the "accounts, books, and affairs" of each Reserve Bank in accordance with the provisions of the Federal Reserve Act. In addition, the GAO performs various special audits of the Federal Reserve as requested by committees of Congress.

Our monetary policies are, of course, continually under Congressional and public scrutiny and debate. Accordingly, I do not believe that there is any need for additional regular audits of the Federal Reserve.

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July 20, 1983

The Honorable Jim Wright
Majority Leader
House of Representatives
Washington, D.C. 20515

Dear Mr. Wright:

The Board of Governors of the Federal Reserve System is pleased to forward to you its Monetary Policy Report to the Congress pursuant to the Full Employment and Balanced Growth Act of 1978.

Sincerely,

S/Paul A. Volcker

Enclosure

DJW:mrk
bcc: Mrs. Mallardi (2)

Identical letters also sent to the attached list.

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House

Jim Wright
Majority Leader (H-148 Capitol Bldg.)

Robert H. Michel
Minority Leader (H-230 Capitol Bldg.)

Thomas S. Foley
Majority Whip (H-114 Capitol Bldg.)

Trent Lott
Minority Whip (1622 LHOB)

Fernand J. St Germain, Chairman
Committee on Banking, Finance and Urban Affairs (2129 RHOB)

Chalmers P. Wylie, Ranking Minority Member
Committee on Banking, Finance and Urban Affairs (2129 RHOB)

James R. Jones, Chairman
Committee on the Budget (214 House Annex I)

Delbert L. Latta, Ranking Minority Member
Committee on the Budget (214 House Annex I)

Lee H. Hamilton, Vice Chairman
Joint Economic Committee (SD-G01)

Walter E. Fauntroy, Chairman
Subcommittee on Domestic Monetary Policy
of House Banking (H2-109 HOB Annex II)

Dan Rostenkowski, Chairman
Committee on Ways and Means (1102 LHOB)

Barber B. Conable, Ranking Minority Member
Committee on Ways and Means (1102 LHOB)

Doug Barnard, Jr., Chairman
Subcommittee on Commerce, Consumer and
Monetary Affairs of House Gov't. Operations (B-377 RHOB)

Jamie L. Whitten, Chairman
Committee on Appropriations (H-218 Capitol Bldg.)

Silvio O. Conte, Ranking Minority Member
Committee on Appropriations (H-218 Capitol Bldg.)

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Senate

Howard H. Baker, Jr.
Majority Leader (S-233 Capitol Bldg.)

Robert C. Byrd
Minority Leader (S-208 Capitol Bldg.)

Ted Stevens
Majority Whip (S-229 Capitol Bldg.)

Alan Cranston
Minority Whip (S-148 Capitol Bldg.)

Strom Thurmond
President Pro Tempore (SR-218)

✓Jake Garn, Chairman
Committee on Banking, Housing and Urban Affairs (SD-534)

✓William Proxmire, Ranking Minority Member
Committee on Banking, Housing and Urban Affairs (SD-534)

Robert Dole, Chairman
Committee on Finance (SD-207)

Russell B. Long, Ranking Minority Member
Committee on Finance (SD-207)

Pete V. Domenici, Chairman
Committee on the Budget (203 Carroll Arms Annex)

Lawton Chiles, Ranking Minority Member
Committee on the Budget (203 Carroll Arms Annex)

Roger W. Jepsen, Chairman
Joint Economic Committee (SD-G01)

Lloyd Bentsen, Senate Ranking Minority Member
Joint Economic Committee (SD-G01)

Mark O. Hatfield, Chairman
Committee on Appropriations (SD-118)

John C. Stennis, Ranking Minority Member
Committee on Appropriations (SD-118)

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July 20, 1983

The Honorable George Bush
President of the United States Senate
Washington, D.C. 20510

Dear Mr. Vice President:

The Board is pleased to submit its Monetary Policy Report to the Congress pursuant to the Full Employment and Balanced Growth Act of 1978.

Sincerely,

S/Paul A. Volcker

Enclosure

DJW:mrk
bcc: Mrs. Mallardi (2)

Identical ltr. also sent to Thomas P. O'Neill, Jr.
Speaker of the House of Representatives
(with 2 copies of the report)

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Federal Reserve Bank of St. Louis

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

PAUL A. VOLCKER
CHAIRMAN

July 20, 1983

The Honorable Bill McCollum
House of Representatives
Washington, D. C. 20515

Dear Bill:

I could not resist sending you the attached table showing estimates of the IMF's use of the U.S. quota over the past 30 years. As you can see, in 14 of those years the United States received net repayments from the IMF.

Sincerely,

Paul

Attachment

bcc: Mr. Truman
Mrs. Mallardi (2) ✓

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Estimates of IMF Drawings (-) and Repayments (+) of U.S. Quota Subscription
(millions of dollars)

Calendar Years

Year	Amount
1953	+ 90
1954	+ 53
1955	+ 150
1956	- 57
1957	- 37
1958	+ 20
1959	- 6
1960	+ 450
1961	- 140
1962	+ 630
1963	+ 20
1964	+ 270
1965	+ 170
1966	+ 296
1967	- 90
1968	- 870
1969	-1,030

Fiscal Years

Year	Amount
1970	- 800
1971	+ 910
1972	+ 990
1973	- 50
1974	- 470
1975	-1,070
1976	-1,205
1977*	- 810
1978	+ 960
1979	+1,330
1980	- 410
1981	-2,360
1982	-1,825

*Includes transitional quarter

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July 20, 1983

The Honorable Fernand J. St Germain
Chairman
Committee on Banking, Finance
and Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Chairman St Germain:

As the House of Representatives prepares to take up the International Recovery and Financial Stability Act, H.R. 2957, I would like to underline the importance of prompt and favorable action by the Congress on the proposed increase in the U.S. quota in the International Monetary Fund (IMF) and in the U.S. commitment to the IMF's General Arrangements to Borrow. I believe U.S. support for this increase in IMF resources is essential to maintain stability and confidence in the international financial system at this critical time.

As you know, an extraordinary cooperative effort is underway to deal with the strains arising out of the heavy indebtedness of many developing countries. That effort involves continuing action by debtors and creditors, and by the governments and central banks of leading countries. But the IMF is the linchpin for the entire effort, providing, as part of its leadership role, a critically needed margin of financing.

Current and prospective demands on the Fund growing out of this process could well exhaust its usable present resources. To strengthen its ability to deal with this situation and to maintain a stable international financial system, these resources must be increased.

I cannot emphasize too strongly that failure of the U.S. to participate in providing the IMF with adequate resources to do its job, as an essential part of an international effort joined by virtually every country of the Western World, would deal a devastating blow to the effort to manage the international financial situation, with clearly adverse consequences for U.S. credit markets and our own economic growth.

Sincerely,

S/Paul A. Volcker

EMT:pjt
bcc: Mr. Truman
Mrs. Mallardi (2) ✓

Identical letter also sent to Cong. Wylie.

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July 18, 1983

The Honorable John H. Chafee
United States Senate
Washington, D.C. 20510

Dear Senator Chafee:

Thank you for your letters of June 30 and July 13 concerning the warrants held by the U.S. government to purchase Chrysler Corporation common stock at $13 per share.

As you are aware, the Loan Guarantee Board has not yet formally resolved the many and complex issues connected with the warrants, but we are working toward an expeditious resolution of this matter. My position has been and remains that the U.S. taxpayer should receive fair value for the warrants in compensation for risk he or she took in guaranteeing the original loans to Chrysler. I can assure you we are working as quickly as possible toward this end.

Thank you again for sharing your views.

Sincerely,

S/Paul A. Volcker

GM:DLK:JLK:mrk
(#V-120 & V-127)

bcc: Mr. Kohn
Ms. Mallinson
Mr. Kichline
Mrs. Mallardi (2) ✓

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ROBERT J. DOLE, KANS., CHAIRMAN

BOB PACKWOOD, OREG.
WILLIAM V. ROTH, JR., DEL.
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JOHN H. CHAFEE, R.I.
JOHN HEINZ, PA.
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DAVID DURENBERGER, MINN.
WILLIAM L. ARMSTRONG, COLO.
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CHARLES E. GRASSLEY, IOWA

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MAX BAUCUS, MONT.
DAVID L. BOREN, OKLA.
BILL BRADLEY, N.J.
GEORGE J. MITCHELL, MAINE
DAVID PRYOR, ARK.

ROBERT E. LIGHTHIZER, CHIEF COUNSEL
MICHAEL STERN, MINORITY STAFF DIRECTOR

United States Senate

COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

July 13, 1983

The Honorable Paul Volcker
Chairman and Governor
Federal Reserve Board of Governors
Federal Reserve Building
Washington, D.C. 20511

Dear Mr. Chairman:

You will recall last month I wrote to you and other members of the Chrysler Loan Guarantee Board to urge the Board to act promptly to market in an orderly fashion the warrants which entitle the federal government to purchase Chrysler Corporation stock for $13.00 per share.

Given the current market price of Chrysler stock, marketing these warrants would yield the taxpayers of the United States a potential profit of over a quarter of a billion dollars.

While I have yet to receive a response, press accounts indicate the Board is preparing a plan to sell the warrants. I hope that this is true. While I do not expect that the warrants be sold in one block, I would hope that the Board will expeditiously agree on a plan for their orderly disposal.

I am writing today to advise you, in advance, that if the Board fails to act, it will be my intention to offer an amendment in the Senate to the Treasury and Postal Service Appropriation bill to reduce the Treasury Department appropriation by $250 million--an amount the federal government could be expected to obtain by marketing these warrants--and to direct the government to sell them, with the proceeds to accrue to the Treasury in lieu of the appropriation. Such an amendment, of course, would not be necessary should the Board decide, in the interim, to sell the warrants, an action I believe would be preferable to a legislative directive.

I look forward to hearing from you.

Sincerely,

John

John H. Chafee
United States Senator

JHC/dst

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July 18, 1983

The Honorable Doug Barnard, Jr.
Chairman
Subcommittee on Commerce, Consumer
and Monetary Affairs
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Chairman Barnard:

Thank you for your recent letter regarding your Subcommittee's oversight hearings on Conditions in the Legal Framework of the American Financial System.

I am pleased to let you know that Michael Bradfield, the Board's General Counsel, will be appearing on behalf of the Board on Thursday, July 21, at 9:30 a.m.

Sincerely,

SZ Paul

CO:DJW:pjt (#V-122)
bcc: Mr. Bradfield
Mrs. Mallardi (2)

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Don Winn will discuss with Chairman

DOUG BARNARD, JR., GA., CHAIRMAN
RONALD D. COLEMAN, TEX.
JOHN M. SPRATT, JR., S.C.
JOHN CONYERS, JR., MICH.
ELLIOTT H. LEVITAS, GA.
HENRY A. WAXMAN, CALIF.

NINETY-EIGHTH CONGRESS

Congress of the United States

House of Representatives

COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS

RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, D.C. 20515

JUDD GREGG, N.H.
WILLIAM F. CLINGER, JR., PA.
TOM LEWIS, FLA.

MAJORITY—(202) 225-4407

7/12

July 6, 1983

Hon. Paul Volcker
Chairman
Federal Reserve Board
Washington, D.C. 20551

Dear Chairman Volcker:

The subcommittee on Commerce, Consumer, and Monetary Affairs of the Committee on Government Operations will hold hearings on July 19, 20, and 21, 1983, with respect to what is widely held to be rapidly developing and massive confusion - which, nevertheless, might bring the benefits of innovation - across the legal framework of the American financial system and services industry. This situation, in turn, carries crucial implications for changes in underlying public policies related to such topics as: the safety and soundness of the entire structure; concentration levels of economic power; the convenience of financial services to corporate and non-corporate consumers; the lines of regulatory authority; and the basic fairness and clarity of the ground rules for "commerce", in that word's broad sense.

I am writing to request your or your representative's testimony for the session commencing at 9:30 A.M., on July 21, 1983, in Room 2154 of the Rayburn House Office Building, on this general subject, especially and to the fullest extent possible concerning those more specific legal features set out in the attached memorandum of interrogatories. Although the subcommittee is interested in views on the advisability of macroalterations in declared public policies, such as the one which now supposedly is separating banking from other forms of commerce, our initial investigations will strongly stress examining the perceptions, if not the reality, of disorder in the structure of financial institutions law and their legalistic sources.

The subcommittee's very broad responsibility and, hence, the expansiveness of its inquest are dictated by three factors which we hope are held in mind as testimony is prepared. First, unlike other divisions of the House, it has clear oversight jurisdiction relating to all the key executive departments or agencies statutorily charged with administering the major laws establishing the national regulatory scheme for financial matters. Second, much, although not all, of the notion of disarray is being generated by either the long established policies of these authorities being turned to unexpected and more aggressive purposes by the private sector or by new policies being adopted or tacitly approved by these instrumentalities. Third, none of these authorities operate in an insular environment. Indeed, their activities can only be assayed in the complex context

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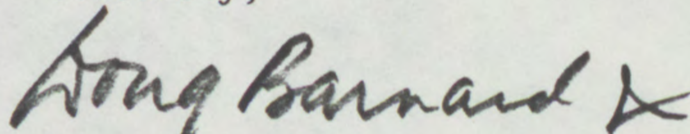
of existing provisions of the U.S. Code and state statutes; an extensive and evolving body of case law; and legislation pending before both the Congress and the states.

Judging from your recent statements before the Committee on Banking, Housing, and Urban Affairs of the Senate in its oversight hearings on "Conditions in the Financial Institutions Industry", your agency's answers to or observations on the attached questions will be essential to our endeavors. I acknowledge that with respect to some of these inquiries, you might be involved in litigation or other similarly sensitive circumstances. Nevertheless, I trust your usual maximum effort to cooperate will prevent voids in the agency's presentation. Additionally, if you wish to raise points of a legal nature, which you believe are important to the overall scope of the hearings but are not raised in the memorandum, I invite you to do so.

I understand that a number of "moratorium" bills are pending in both chambers and that a far reaching financial reform bill is about to be introduced in the Senate, the general contents of which are well known. While brief views on these proposals would be expected, please let me restate that our primary interest is in an investigation of the law as we have it today and your views on its cogency or lack thereof.

We would appreciate receiving 100 copies of your written testimony at the Commerce, Consumer, and Monetary Affairs Subcommittee office (Room B-377 of the Rayburn House Office Building) at least 24 hours prior to the hearing. Also, upon receipt of this invitation, would you be so kind as to have the appropriate member of your staff contact Richard Peterson at the subcommittee, (202) 225-4407?

Sincerely,



Doug Barnard, Jr.
Chairman

DB:dwp:v

Attachment

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Memorandum of Interrogatories
Hearings Before the Subcommittee on Commerce, Consumer, and Monetary Affairs
Committee on Government Operations
U.S. House of Representatives
July 19, 20, and 21, 1983
on
Conditions in the Legal Framework of the
American Financial System and Service Industry

These interrogatories are multi-purpose. They are the same for all witnesses on all three days and also serve as briefing documents for members of the subcommittee and their staffs. Consequently, a given witness might have to make a common sense rendering of the text to establish the points of applicability to him.

I. Nonbank Banks and the Bank Holding Company Act (BHCA), in General

The BHCA at 12 U.S.C. 1841(c) defines a "bank" to mean "any institution organized under the law of the United States, any State....which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." Given a number of nuances from specific situation to specific situation, many purchasers or would-be charterers of banking institutions organized under the law of the United States or a State of the United States are claiming such institutions would not fall under 12 U.S.C. 1841(c)--and thus the entire BHCA and its clauses "separating banking and commerce" would be largely obviated--if one forewent either (1) or (2) above. These are the claims which have given rise to the phrase "nonbank banks," institutions chartered as banks, but not banks *for the purposes of the BHCA.*

A. Background--The Business of Making Commercial Loans

Many of the assertions of avoidance of the BHCA through nonbank banks are being made on the grounds the institutions are not or would not be in the business of making commercial loans due to voluntary agreement not to engage in that business. In answering the questions below, please hold in mind the following historical factors.

(1) In a letter dated July 1, 1971, the Federal Reserve stated that a bank would not be covered by the BHCA if it terminated its commercial loan business. The letter also stated the Board's view that:

> Commercial loans are considered all loans to individuals or businesses, secured or unsecured, other than a loan the proceeds of which are used to acquire property or services used by the borrower for his own personal, family, or household purposes, or for charitable purposes.[1]

(2) In a letter dated May 18, 1972, the Board stated that a bank would not fall under the BHCA if it made only *occasional* commercial loans. It also stated:

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> The Board understands that Boston Safe purchases "money market instruments", such as certificates of deposits, commercial paper, and bank acceptances. In the circumstances of this case, such transactions are not regarded as commercial loans for the purposes of the act. [Emphasis supplied]

It continued:

> A further aspect of Boston Safe's operations is its engagement in Federal funds transactions which, according to Boston Safe's 1971 Report of Condition, amounted to $8 million of Federal funds sold outstanding as of December 31, 1971. The Board had previously taken the position and continues to adhere to the position, that the sale of Federal funds constitutes an unsecured loan. The Board has concluded, however, that the sale of Federal funds by Boston Safe is not tantamount to the making of a commercial loan for the purposes of the Act. [Emphasis supplied][2]

(3) In a letter dated January 26, 1976, the Board again issued an opinion relative to the meaning of "commercial loan." It concerned an inquiry whether "broker call loans" would constitute "commercial lending." The Board concluded that they would not.[3]

(4) In a series of letters and applications in 1982-83, very converse situations seem to have developed with respect to the acquisition of Lincoln State Bank of New Jersey. This is an existing nonmember bank, insured by the Federal Deposit Insurance Corporation (FDIC). In October 1982, Dreyfus Corporation, mainly a provider of investment advisory services but also the owner of distributors of certain kinds of securities (largely mutual funds) announced its intention to buy this bank. Under the Change in Bank Control Act (CIBCA), such a transaction is subject to FDIC approval, unless it results in the formation of a bank holding company, in which case Federal Reserve Board approval is required. See 12 U.S.C. 1817(j).

Due to the fact that it seemed unlikely the Board would approve such an acquisition since it could be deemed an avoidance of the separation of banking and commerce, Dreyfus, in its application, promised the FDIC it would divest Lincoln's commercial loans although it would continue to purchase certificates of deposit and similar market instruments.

In a letter dated December 10, 1982, from the Federal Reserve to the FDIC, it was stated:

> ...(T)he Board has consistently held that a commercial loan under the BHC Act is any loan other than a loan the proceeds of which are used to acquire property or services used by the borrower for personal, family, household, or charitable purposes. This definition of commercial loan is broad in scope and includes the purchase of such instruments as commercial paper, bankers acceptances, and certificates of deposit, the extension of broker call loans, the sale of federal funds, the deposit of interest bearing funds and similar lending vehicles. These transactions both in law and in substance, establish a debtor-creditor relationship between the business enterprizes for purposes that are not

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personal, family, household or charitable. [Emphasis supplied.][4]

In direct opposition to this letter, the FDIC approved the acquisition without referring the matter to the Federal Reserve Board. Additionally, the FDIC directly challenged the Federal Reserve's opinion in a letter dated January 3, 1983. The Corporation stated:

> We have reviewed analogous acquisitions of "nonbank banks" and note that a number of clear precedents exist, dating back a number of years, for the bank to be held exempt from the definition of "bank" in the Bank Holding Company Act based on divestiture of its commercial loan portfolio prior to the acquisition, and agreement not to engage in the business of making commercial loans in the future. By failing to object previously to that now fairly routine practice, the Federal Reserve Board has, in our judgment, acquiesced in, if not expressly agreed with, a more limited definition of commercial loan on which the public has come to rely. [Emphasis supplied.][5]

(5) In a series of letters and applications in 1982-83, a very converse situation also seems to have developed with respect to the chartering of a new national bank for the Dreyfus Corp. by the Comptroller of the Currency. In a letter to the Comptroller dated December 14, 1982, the Federal Reserve Board strongly protested granting of the charter on the grounds it would violate the BHCA. (The Board also asserted violations of the Glass-Steagall Act, which prohibits affiliation of member banks--all national banks being required to be members banks of the Federal Reserve System--and firms principally engaged in certain securities activities. This aspect of the December 14, 1982, letter is covered in II. Banks, Nonbank Banks, the Bank Holding Company Act, and the Glass-Steagall Act, below.)

With respect to the claimed violation of the BHCA, the Comptroller, in granting the charter on February 4, 1983, noted that the Board's latest interpretation of what is a commercial loan, "...appears to constitute an abrupt and profound departure from the Board's past interpretations of the BHCA term...." He went on to note that the new interpretation, "is not supported by the purpose or legislative history of the BHCA." Additionally and shortly before this action, the Comptroller had granted a charter to J. & W. Seligman Company in somewhat similar circumstances but only to the extent of permitting Seligman to form a trust company. On April 3, 1983, the Federal Reserve indicated it would not issue Federal Reserve stock to this newly chartered national bank, a requisite under the law for all national banks. The Comptroller's office strongly countered that the issuance of such shares was merely a "ministerial act." The Federal Reserve then agreed to issue the stock but with a clear threat of assessing monetary penalties against Seligman at a possible $1,000 per day for violations of assorted statutes. To date, no such penalties have been assessed.[6]

(6) As of the date of this invitation to testify, no litigation has been brought by the Federal Reserve, to the best of the subcommittee's knowledge, in the matters of Dreyfus/Lincoln, Dreyfus National Bank, or Seligman. Additionally, in light of all these circumstances, it appears Prudential Insurance Company of America, J.C. Penney & Co., Merrill Lynch & Co., Aetna

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Life and Casualty, and Beneficial Corp. have announced their intention to acquire banks under conditions similar to those pertaining to Dreyfus/Lincoln.[7]

(7) In late May 1983, the Federal Reserve put out for comment an extensive amendment to 12 C.F.R. Part 225, Regulation Y, which would, supposedly, impose its more expansive definition of commercial loan on the FDIC and the Comptroller. Comments are due in late July 1983.

B. Questions--The Business of Making Commercial Loans
(Please do not consider Glass-Steagall issues regarding these questions.)

(1) Is the above background an accurate summary of developments respecting "commercial loans" on the date of the hearing? What points of a legal nature would you add or correct?

(2) Under the Change in Bank Control Act, was the FDIC's position, in allowing Dreyfus to acquire Lincoln State Bank of New Jersey, sound?

(3) Under the Change in Bank Control Act and in light of the Comptroller's general position in chartering a new national bank for Dreyfus Corporation, would the Comptroller be entitled to authorize the acquisition of an existing national bank? Would he be compelled to, assuming other requirements of the Change in Bank Control Act were met?

(4) What are the key differences, from a precedential point of view, between industrial banks--which can be insured by the FDIC under the Garn-St Germain Act; are long-standing, permitted activities for bank holding companies under 4(c)(8) of the BHCA; and do invest in money market instruments--and nonbank banks?

(5) Would the definition of "commercial loan" in the Federal Reserve's proposed revision of Regulation Y bind the FDIC and the Comptroller in light of the Federal Reserve's power at 12 U.S.C. 1844(b) to "...issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this Act and prevent evasions thereof."?

(6) Have the diverse opinions of the FDIC, Comptroller, and Federal Reserve on the meaning of "commercial loan" been matters solely of administrative discretion, or are there statutes or matters of legislative history which have necessitated this diversity?

(7) Do you believe this diversity has impaired the fairness of the ground rules for engaging in the depository business?

(8) Should Congress more specifically define "commercial loan," direct the Comptroller, FDIC, and Federal Reserve to reach a uniform definition, or empower the Federal Financial Institutions Examination Council to reconcile differences in this area as well as others when there is severe inability to agree on crucial points?

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C. Background--Accepting Demand Deposits

In Wilshire Oil Company v. Board of Governors of the Federal Reserve System, 668 F.2d 732 (3rd Cir.) 1981, cert. den. 102 S.Ct. 2958 (1982), the court expressed a view that the Board's authority was very broad when it came to defining a "demand deposit." Under its interpretation at 68 Fed. Res. Bull. 253, 253-54 (1982), NOW accounts were held to be equivalent to "demand deposits," even though, technically, a financial institution holding a NOW account may require between 14 and 30 days prior notice before permitting a withdrawal from the account. Further, the Board, in its proposed revisions to Regulation Y, mentioned in I. above, would hold NOW accounts to be "demand deposits."

However, in cases of the Comptroller's chartering of new national entities for the Dreyfus Corporation and Seligman Corporation, nothing resembling a "demand deposit" was going to be offered.

D. Questions--Accepting Demand Deposits
(Please do not consider Glass-Steagall issues regarding these questions.)

(1) Is the above background an accurate summary of developments respecting "demand deposits"? What points of a legal nature would you add or correct?

(2) In your view, is it proper to interpret a NOW account as a "demand deposit"? Why or why not?

(3) In cases where the institution plans to offer nothing resembling a "demand account," can the Board's authority under 12 U.S.C. 1844(b), allowing it to issue regulations to prevent evasion of the BHCA, stretch to cases of very short term certificates of deposit? For example, could the Board declare a 30 day certificate of deposit to be equivalent to a "demand deposit" for purposes of the BHCA?

II. Banks, Nonbank Banks, the Bank Holding Company Act, and the Glass-Steagall Act

A. Background

The phrase "Glass-Steagall Act" can be used, technically, to refer to both the Banking Act of 1932 and the Banking Act of 1933. Here it is used only in its more popular meaning--Sections 16, 20, 21, and 32 of the Banking Act of 1933, 48 Stat. 162 (1933).

Section 16 restricts the investment activites of national banks to three areas--acting as agent; purchasing limited kinds of very high quality securities for its own account; relatively free underwriting and dealing in certain U.S. and state/municipal general obligations and securities for its own account. The scope of this section covers only national banks and, by virtue of 12 U.S.C. 355, other members of the Federal Reserve System.

Section 20 prohibits bank affiliation with any business entity engaged principally in investment banking activities--the business of underwriting, distributing, and selling stocks and securities, except as allowed by Section 16.

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The scope of this section covers only member banks of the Federal Reserve System, including therefore, all national banks.

Section 21 prohibits a bank to engage in investment banking and receive deposits at the same time, except as permitted under the limited exceptions of Section 16, again mostly related to U.S. government securities and general obligation bonds of states and municipalites. The scope of this section covers all banks and other depository institutions, including most especially, for this Part II of these interrogatories, FDIC insured nonmember commercial banks, though not necessarily the affiliates of FDIC insured nonmember commercial banks.

Section 32 prohibits interlocking directorates and certain other relationships between member banks and firms or individuals primarily engaged in investment banking. The scope of this section covers only Federal Reserve member banks, and therefore, all national banks.

Broadly, the purpose of these clauses is commonly held to be "to separate banking and commerce." There have been a number of judicial cases, however, which have made specific interpretations of this separation--both "tightening" and "loosening." With example to "tightening," in Investment Company Institute v. Camp, 409 U.S. 617 (1971), regulations of the Comptroller permitting a national bank to operate a mutual fund were struck down as contravening both Sections 16 and 21.

With example to "loosening," in Board of Governors of the Federal Reserve System v. Investment Company Institute, 405 U.S. 46 (1981), the Supreme Court upheld a Federal Reserve Board regulation which allows a bank holding company to act as an investment adviser to a closed-end investment company despite Section 21. In New York Stock Exchange v. Smith, 404 F. Supp. 1091 (D.D.C. 1975), the court upheld plans of both national and Federal Reserve member banks in which a certain amount of money is automatically deducted from a customer's account and invested in the common stock of one or more companies selected by the customer from a list supplied by the bank. In A.G. Becker, Inc. v. Board of Governors of the Federal Reserve System, No. 80-2258 (D.C. Cir. Nov. 2, 1982), the court upheld the legality of a bank's dealing in commercial paper on the grounds, inter alia, that it was not a "security" under the meaning of the Glass-Steagall Act. The case is now on appeal to the Supreme Court.

In the regulatory arena, a number of developments either now--or in all probability later could--involve newer suits. On August 26, 1982, the Comptroller approved an application by Security Pacific National Bank to establish a discount brokerage service to act as a broker-dealer under the Securities Exchange Act. The division is to engage in the purchase and sale of all types of securities, provide margin loans, and offer its services to the general public. However, investment advice will not be provided. The Comptroller's approval maintained that these services are fully authorized for national banks under Section 16 of the Glass-Steagall Act, which permits banks to purchase and sell investment securities without recourse, solely upon the order, and for the account of customers. This approval is now under litigation in Securities Industry Association v. Conover, No. 82-2865 (D.D.C., Oct. 6, 1982).

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In October 1982, the Comptroller approved a Citibank application to offer individual retirement accounts invested in a common trust fund maintained and managed by the bank. This decision is now being challenged in Investment Company Insitute v. Conover, No. 83-0549 (D.D.C., Feb. 24, 1982) on the basis that the proposed Citibank activity violates the Glass-Steagall Act's prohibition on bank securities underwriting and distribution of securities.

In January 1983, the Federal Reserve Board approved an application of BankAmerica Corporation to acquire Charles Schwab & Co., a discount brokerage firm, and rejected the argument it would violate Glass-Steagall. The Board also found the acquisition did not violate the BHCA.

In both views, it has been joined by the SEC, in a letter of April 11, 1983, and by the Department of Justice, in a letter of April 8, 1983, relating to the Federal Reserve's proposed regulation to expand the Schwab decision to full status as a regulation under the BHCA.

To the subcommittee's knowledge, no litigation is pending in the Schwab situation at the time of this invitation.

Whereas the sheer complexity of these judicial and regulatory circumstances raise inherent problems related to legal clarity and fairness, two situations directly intertwine the matters of banks, nonbank banks, the Bank Holding Company Act, and the Glass-Steagall Act.

First, on May 9, 1983, the FDIC proposed a regulation that would allow state nonmember FDIC insured banks to own affiliates engaged in the entire line of securities transactions. In other words, it proposed virtually to terminate Glass-Steagall for those banks. It did this on the grounds that Sections 16, 20, and 32 of the Glass-Steagall Act apply only to banks which are members of the Federal Reserve.

Further, according to the Corporation, affiliates of state nonmember banks, which distinct entities do not themselves engage in the taking of deposits but only in the securities business, are not covered by Section 21 of the Glass-Steagall Act and the state nonmember banks, as distinct corporate entities themselves, are not engaged in the securities business, just their affiliates are.

This proposed regulation relates to commercial banks. The FDIC is already involved in litigation on closely related situations. For instance, the Boston Five Cents Savings Bank, a savings as opposed to a commercial, bank--which is, nevertheless under FDIC jurisdiction since that savings bank is insured by the Corporation--has announced its intention to engage in securities activities vis a vis subsidiaries. The FDIC has refused to object on Glass-Steagall grounds. This has led to Investment Company Institute v. FDIC No. 82-1721 (D.C. Cir. Feb. 3, 1983), in which there has been no decision, to the knowledge of the subcommittee, as of the date of the invitation to this hearing.

To a some degree, the importance of this position of the FDIC will depend on state legislation allowing these activities to state nonmember banks and their affiliates. Apparently, most states have statutes limiting their banks so as to prevent these affiliations by state law. However, some

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states have "leeway" laws, which allow state banks to invest varying percentages of their deposits or capital in the shares of a corporation engaged in any activity. These might allow the FDIC proposal to take practical effect regardless of the absence of specific legislation. See, for example, Mass. Ann. Laws Ch. 167 F, Section 3(4).

Second, the Comptroller and the FDIC have permitted Dreyfus Corporation both to charter and to acquire banks, as noted in Part I. One of the objections of the Federal Reserve to the chartering of the national bank by the Comptroller was that it would constitute a violation of Glass-Steagall. In this case, the Comptroller, in essence, said that the new national bank was a nonbank bank for purposes of the Bank Holding Company Act and that its chartering and affiliation with Dreyfus did not violate Glass-Steagall because Dreyfus was neither principally nor primarily involved in the investment banking business, despite some distribution of securities. In the case of the acquisition of New Jersey State Bank by Dreyfus, the FDIC found essentially the same thing as did the Comptroller, except its grounds, of course, were that New Jersey State Bank, a state nonmember bank, a distinct corporate entity, was only affiliated with Dreyfus and would not, therefore, violate Section 21.

B. Questions

(1) Is the above background an accurate summary of developments respecting banks, nonbank banks, the BHCA, and the Glass-Steagall Act on the date of the hearing? What points of a legal nature would you add or correct?

(2) Was the 1981 letter from Robert McConnell, Assistant Attorney General for Legislative Affairs, to Chairman Jake Garn (reprinted in the Financial System Hearings Before the Senate Committee on Banking, Housing, and Urban Affairs, 97th Cong., 1st Sess. 141 (1981), which stated money market mutual funds of securities firms, though often subject to near demand withdrawal in practice, were not deposits for Section 21 purposes, legally sound? Is the subcommittee correct in its understanding that this opinion has never been challenged in the courts?

(3) Does the basic thrust of the "separating" regulatory scheme in Glass-Steagall continue to make cogent law in light of the McConnell letter?

(4) What is the current status in the courts of Investment Company Institute v. FDIC, cited above? Considering the trend of the cases, how likely is the FDIC to prevail in its interpretation of Section 21? Please explain your reasons.

(5) Although believing that states will have to alter statutes if the FDIC's interpretation of Section 21 is to have widespread practical effect, what, nevertheless, is the potential of using "leeway" statutes, such as that cited above from Massachusetts, to effect, to a limited degree, the FDIC's policies?

(6) Considering the trend of cases, how likely is A. G. Becker to prevail in its case regarding banking and commercial paper? Please explain your reasons.

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(7) Why is Glass-Steagall, which has been in effect since 1933, with only one major amendment in 1935, suddenly being subjected to a rising tide of litigation and differences of interpretation among regulatory agencies, such as that now splitting the FDIC, Comptroller, and Department of Justice from the Federal Reserve as to the meaning of Section 21?

(8) If the statute is subject to such controversy, should the Congress "tighten" it to make clearer the "separation of commerce and banking" or should that separation be relaxed? If the latter, what qualifications would you suggest be placed on that relaxation?

III. Banks, Their Insurance Activities, and the Bank Holding Company Act

A. Background

The insurance activities in which banks and bank holding companies can be engaged have a long and involved history. Basically, however, after the enactment of Title VI of the Garn-St Germain Act, P.L. 97-320 at Section 601, these activities were severely restricted. This statute amended the BHCA at its Section 4 so as to mean that providing insurance as a principal, broker, or agent, is not an activity that is closely related to banking and, therefore, not a permissible activity for a bank holding company, with seven limited exemptions. Since banks, themselves, as opposed to their holding companies, also have limited insurance powers under either the National Bank Act at 12 U.S.C. 92 or under the laws of most of the respective states, commercial banking organizations have been thought to be precluded from insurance. The exceptions are for such situations as dealing in credit life, disability, or involuntary unemployment insurance, as dealing in insurance generally in areas where populations are small, say, under the 5000-person community rule of the National Bank Act's 12 U.S.C. 92, or as where the holding company which might be involved is quite small.

However, Section 3(c) of the Bank Holding Company Act covers the basic criteria for the establishment of a bank holding company and for the expansion of a bank holding company's ownership of banks. These criteria are, fundamentally, that the Board may not approve acquisitons that would result in a monopoly or restrain trade and that it may consider the financial and managerial resources of the holding company in passing on formation or expansion.

These standards apparently do not allow the Board to deny applications for formation or expansion/acquisition on the grounds that, at state law, the bank can engage directly in activities which would not be allowed under Section 4 of the BHCA. In other words, if, under currently rare state laws, a bank could engage in insurance to degrees not permitted under Section 4, as amended by Title VI of the Garn-St Germain Act, the Board could not refuse a bank holding company's application to buy the state bank on the grounds of Section 4 avoidance or make the holding company divest these insurance activities as a condition of approval. This seemingly was the rational in Piedmont Financial Service, Inc., 59 Fed. Res. Bull. 766 (1973). Further, under the Piedmont case, the Board allowed a wholly owned subsidiary of such a state bank to engage in

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the range of insurance that would also be permitted to the bank itself.

The subsidiary arrangement in Piedmont is arguably, however, discretionary with the Board since not only is it subject to Section 3 of the BHCA, but it is also subject to Section 4 where the Board's discretion is wider. Indeed, the Federal Reserve seems to be considering overturning the "subsidiary" portions of Piedmont in order to control a situation which is evolving in South Dakota. There, new state law permits state banks and their subsidiaries to engage in all facets of the insurance business and opens such banks to acquistion by out-of-state holding companies. (Both Citicorp and First Interstate Bancorp are interested in pursuing the possibilities inherent in this situation.)[8]

The question of the use of Sections 3 and 4 of the BHCA to avoid Title VI of Garn-St Germain also has arisen in petitions filed on May 27, 1983, by the Independent Insurance Agents of America before the Federal Reserve to quash the insurance activities of Hawkeye Bancorp in Iowa and Marshall and Ilsley Corp. in Wisconsin, in both of which jurisdictions insurance activities are permitted for state banks to a greater degree than seems permissible under the Garn-St Germain Act.

B. Questions

(1) Is the above an accurate summary of developments regarding banks, their insurance activities, and the Bank Holding Company Act?

(2) Could the Board halt the insurance activities of subsidiaries of state banks--which banks are, in turn, the subsidiaries of, say, an out-of-state bank holding company--under Section 4 if the banks would be permitted to engage directly in those insurance activities by state law?

(3) Could the Board halt the direct insurance activities of state banks themselves where: no insurance subsidiaries are involved; state law clearly allows the activity for the bank; and the application to become part of a bank holding company only involves Section 3 of the BHCA? Could Section 5 of the BHCA, granting the Board authority to "issue such regulations and orders necessary to enable it to administer and carry out the purposes of this Act and prevent evasion thereof" be used to this purpose?

(4) Assuming a state bank that divests itself of its "commercial loans," however defined, asserts nonbank bank status, claims escape, thereby, from the entire BHCA, and is in a jurisdiction permitting a high degree of insurance activities for state banks, what would be the Board's legal position be in halting the insurance activities of the nonbank bank or its subsidiaries if the nonbank bank is owned by a company which in no other way could potentially be considered a bank holding company?

IV. Banks and Nonbank Banks with Respect to Interstate Operations under the Douglas Amendment to the Bank Holding Company Act

A. Background

On February 4, 1983, the Comptroller approved the application of the

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Citizens Fidelity Corporation, a Kentucky bank holding company, to charter a limited purpose national bank in Ohio. The main purpose of the new national bank is to conduct the credit card operations for the parent bank holding company to take advantage of Ohio's higher usury structure. However, since Ohio does not specifically permit an out-of-state bank holding company to acquire a bank in Ohio, the chartering of such a bank would be prohibited by the Douglas Amendment to the BHCA, 12 U.S.C. 1842(d). This clause allows such interstate bank holding company (bhc) operations only if a state specifically permits an out-of-state bhc to operate a bank in its borders.

To avoid this restriction, the new bank will not accept demand deposits or make commercial loans. This would seemingly take it out of the definition of a "bank" for BHCA purposes and avoid the Douglas Amendment. However, since Citizens Fidelity is already a bank holding company, the approval of the Federal Reserve Board is necessary even if the new entity is not considered a bank.

On the other hand, Dimension Financial Corporation, which is not now a bank holding company, has submitted applications to the Comptroller to establish 31 national banks in 25 states. These banks, according to their applications, will not engage in the making of "commercial loans," however defined. As with the Kentucky/Ohio situation, the theory here is that these would be nonbank banks and, consequently, not subject to the Douglas Amendment.

B. Questions

(1) Is the above background an accurate summary of developments respecting banks and nonbank banks under the Douglas Amendment to the BHCA? What points of a legal nature would you add or correct?

(2) In what manner could the Federal Reserve halt Dimension if the Comptroller elects to charter the national banks involved?

(3) If the Federal Reserve Board cannot or will not halt Dimension, how seriously is the Douglas Amendment impaired? For example, could a company have banks in some states which took no demand deposits but made commercial loans in or from those states while also having banks in other states which took demand deposits in these other states but made no commercial loans in or from these other states? In other words, could there be a "banking company" which arranged its affairs so that it had "commercial lending" nonbank banks in some states and "demand deposit taking" nonbank banks in other states?

V. Thrift Institutions and Commercial Banks, in General

A. Background--Excluding Bank and Thrift Holding Company Matters

Basically, there are two types of thrift institutions--savings and loan associations and mutual savings banks. The first has, traditionally, existed to promote savings and make mortgages. The second, while also concentrating on mortgages and savings, has customarily had more diversified powers, especially in the making of personal loans. It would be impossible, here, to summarize the innumerable nuances which have characterized differences in these two kinds of firms since some have been chartered under widely varying state laws while others have been chartered under federal statute. Consequent-

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ly, this background only takes in their evolution since the mid-1970's. These high points outline a decisive trend toward both sorts of institutions becoming nearly the same, in liability/asset/corporate form terms, as banks. The outline also, for the sake of brevity, emphasizes developments with respect to savings and loans and mutual savings banks which are federally chartered, as opposed to those which are state chartered.

1. Savings and Loan Associations and Savings Banks

Until the mid-1970s, all federally chartered savings and loan associations were required by law to be organized as mutual associations. However in 1973, the Federal Home Loan Bank Board (FHLBB) was given the authority to approve the conversion of federal mutual associations to Federal stock associations, first on a limited basis, and after 1976 without restriction. The law, however, still prevented *de novo* federal stock savings and loan associations and placed certain restrictions on the conversion of state chartered stock associations--equity based firms which were permitted in some states--to federal stock status. This situation has been completely revised under the provisions of the Garn-St Germain Act. Under this act, the FHLBB is free to charter federal savings and loans (fs&ls) as either stock or mutual organizations, whether *de novo* or through the conversion of eligible state savings and loans (ss&ls). Moreover, all federal associations (or those seeking to convert to federal status) may elect to be chartered either as a savings and loan association (stock or mutual) or as a federal savings banks (stock or mutual). The FHLBB was also given the authority to charter federal savings banks *de novo*.

Both federal savings and loans and federal savings banks are given essentially equivalent powers. The Depository Institutions and Monetary Control Act of 1980 greatly expanded the powers of of federal savings and loan associations. It allowed them to, *inter alia*: offer NOW accounts, credit cards, trusts, and a wide variety of consumer loans. It also allowed them to, *inter alia*: invest in commercial paper, certain kinds of corporate debt instruments, and loans secured by commercial real estate. The Garn-St Germain Act granted these same powers to federal savings banks, and it then added to the powers of both federal savings and loans and federal savings banks a long list of functions which brought their powers virtually to a par with those of commercial banks. Some percentage restrictions remain on how much federal savings and loans and federal savings banks can invest in certain activities or accept certain liabilities. These, limitations, however, seem of evermore limited, practical effect in distinguishing the three kinds of depositories.[9]

(2) Savings Banks--Special Features

Federal savings banks are essentially like federal savings and loans, under current law, as noted. However, a federal savings bank which was previously a state chartered savings bank may continue to engage in activities formerly allowed it under state law, even if those activities are broader than those now permitted under federal law, a matter which mostly relates to the ownership of common stock.

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Federal savings banks must become members of the Federal Home Loan Bank System and must be insured by the Federal Savings and Loan Insurance Corporation, with one exception. This exception is for Federal savings banks which were formerly state chartered mutual savings banks, insured by the FDIC. These institutions may retain their FDIC insurance.[10]

It should be noted that the entire savings bank legal apparatus provides a set of very complex possibilities. There can be these types of savings banks: (1) Federal stock savings banks, chartered by the FHLBB, and insured by the FSLIC; (2) Federal stock savings banks, chartered by the FHLBB, but insured by the FDIC; (3) Federal mutual savings banks, chartered by the FHLBB, and insured by the FSLIC; (4) Federal mutual savings banks chartered by the FHLBB, but insured by the FDIC; (5) state stock savings banks, chartered by their respective state governments, and insured by the FDIC; (6) and state mutual savings banks, chartered by their respective governments, and insured by the FDIC.

This complex arrangement induces some very difficult analytical problems since the Garn-St Germain Act exempts some of these kinds of savings banks from the Bank Holding Company Act and places them under the Savings and Loan Holding Company Act (SLHCA) while leaving other kinds of savings banks in an ambiguous position with respect to both the BHCA and the SLHCA. See Question 6 below.

Finally, it is important to realize all these kinds of institutions have virtually unfettered ability to change back and forth on their source of charter, federal insuring agency, and consequently, regulatory authority.

B. Questions

(1) Is the above an accurate summary regarding recent, important developments related to thrifts and banks in general? What features of an important legal nature would you add or correct?

(2) Some have said that the Garn-St Germain Act really allowed thrifts to surpass commercial banks in terms of powers. Without discussing the adjunct questions of holding company and service company formats which are different for thrifts and for commercial banks, would you agree with that assertion? Please explain.[11]

VI. Thrift Institutions, the Savings and Loan Holding Company Act, Commercial Banks, and the BHCA

A. Background

Under the BHCA, a bank holding company can now operate subsidiaries, besides banks themselves, that: make loans; operate an industrial bank; act as investment advisers; provide certain leasing services; provide limited data processing services; act as insurance agents or brokers in the limited fashions noted in Part III of these interrogatories; engage in real estate appraisal; and, in most respects, do through subsidiaries what the banks could do themselves, with the exception of taking deposits.[12]

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Companies that control federally insured savings and loans or federal savings banks, whether they are insured by the FDIC or the FSLIC, are subject to the Federal Savings and Loan Holding Company Act. Under this Act, a company that owns only one savings and loan or one federal savings bank may engage in any other business activity, without restrictions, if the savings and loan or savings bank qualifies for s&l tax status under 7701 (A19), IRC. (See below on IRC.) Under these, Sears Roebuck operates a retailing business, a securities firm, and a savings and loan association.[13]

In the case of a company that owns more than one savings and loan association, the company, i.e. the holding company, can engage in a wide range of activities as long as they are "a proper incident to the operations of insured institutions and not detrimental to the interests of savings account holders there in." The FHLBB, which has interpretive authority over this standard in the SLHCA has allowed a much broader range of activities for multiple savings and loan holding companies under this clause than the Federal Reserve Board has permitted for bank holding companies under Section 4 of the BHCA.[1$]

It should again be noted that under the Garn-St Germain Act at 12 U.S.C. 1841(c), no institution which is insured by the FSLIC, which covers nearly all savings and loan associations, or chartered by the FHLBB, which consequently covers federal savings banks, is subject to the BHCA.[15]

Additionally, federal savings and loans and federal savings bank subsidiaries of savings and loan holding companies are subject to the office branching rules of the FHLBB which are much more liberal than those covering federally (nationally) chartered commercial banks which are bound by the McFadden Act.[16]

Finally, many of the advantages federal savings and loans and federal savings banks enjoy under the structure of the Savings and Loan Holding Company Act are conditioned on them meeting the requirements of Section 7701 (A 19) of the Internal Revenue Code. This sets forth an asset composition test which would seem to require the thrift institutions in the holding company to invest heavily in mortgages to keep advantages of structure, as well as of tax reduction.[17]

B. Questions

(1) Is the above an accurate summary of developments regarding thrift institutions, the Savings and Loan Holding Company Act, commercial banks, and the BHCA? What features of an important legal nature would you add or correct?

(2) Would you agree with the conclusion that, when the powers of federal savings and loan associations and federal savings banks, including their branching capacity, are added to the authorities under the Federal Savings and Loan Holding Act, the resulting conglomerate could outdistance, if full legal potentials were deployed, a conglomerate formed under the Bank Holding Company Act, in terms of diversified services.

(3) In what ways can the asset composition test of Section 7701 (A19) of the Revenue Code be interpreted so as to allow thrift organizations and their affiliates the structural advantages of the Savings and Loan Holding Company Act and other statutes allowing for diversification of activities,

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such as the emergency takeover provisions of the Garn-St Germain Act, without maintaining a commitment to housing? Could the thrift institutions calculate for the asset composition test only at the end of the year? Could they originate commercial loans and sell them off to a commercial lending subsidiary inside the overall thrift holding company apparatus?

(5) Assuming there are decided advantages to being a federal stock savings bank or federal stock savings and loan association and falling under the Savings and Loan Holding Company while being exempt from the BHCA, what legal detriments and difficulties are involved in converting from a state or national commercial bank to these stock thrift forms, outside of those which might be connected to the above cited portion of the Internal Revenue Code?

(6) With respect to savings banks which are not insured by the FSLIC or chartered by the FHLBB, to what extent are they subject to the BHCA?

VII. Thrift Institutions, Thrift Service Corporations, Commercial Banks and the Bank Service Corporation Act

A. Background

Section 5(c)(4)(B) of the Home Owners Loan Act, 12 U.S.C. 1464 (c)(4)(B), permits federal thrifts, meaning federal savings and loan associations and federal savings banks, to invest up to 3% of their assets in the capital stock, obligations, and other securities of service corporations. By regulation, the FHLBB has the power to set the service limits of these corporations and has done so very broadly. Moreover, there is nothing to prevent a number of federal thrifts from joining together to form a service corporation of any size.[18]

The FHLBB now permits these corporations to do such things as develop and manage real estate, broker most forms of insurance, and even prepare tax returns. Indeed, its expansion of the list of activities by regulation to include the manufacture of mobile homes, the sponsoring of mutual funds,and the brokering of real estate was only stopped by language in the conference report on the Garn-St Germain Act. There remains no statutory prohibition on the list of activities such service corporations could undertake.

In contrast, amendments by the Garn-St Germain Act to the Bank Service Corporation Act at 12 U.S.C. 1861-1867, allow bank service corporations, with the prior approval of the Federal Reserve, to engage in only those activities, other than deposit taking, that are permissible for bank holding companies under the BHCA.

B. Questions

(1) Is the above an accurate summary of developments regarding thrift institutions, thrift service corporations, commercial banks, and the Bank Service Corporation Act? What features of an important legal nature would you add or correct?

(2) Although the conference committee report on Garn-St Germain halted expansion of thrift service corporation activities by regulation, is it your opinion that, on a case by case basis, these service corporations

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could expand their lines of activity by application, without benefit of a specific, permissive, general regulation?

(3) What is your opinion of the view that a thrift service corporation which is offering brokerage services, as with the case of "Invest," is in violation of the Glass-Steagall Act's Section 21? Do you have any further views on the assertions being made in Securities Industry Association v. Federal Home Loan Bank Board, No. 82-1920 (D.D.C., July 12, 1982) in which this Section 21 issue is also at stake?

(4) Do you have any suggestions for correcting the anomalous competitive situations between bank service corporations and savings and loan service corporations?

VIII. Miscellaneous Questions

(1) Are the general antitrust laws adequate to prevent anti-competitive developments in the context of a changing and, presumably, highly concentratable financial services industry? Would you sugesst changes in the Bank Holding Company Act, the Bank Merger Act, the Savings and Loan Holding Company Act, the McFadden Act, the Sherman Act, the Clayton Act, or the Depository Institutions Management Interlocks Act?

(2) Are anti-tying provisions of the Bank Holding Company Act at 12 U.S.C. 1971-78 and of the Garn-St Germain Act, now codified at 12 U.S.C. 1464(q), adequate to protect the consumer from predatory practices of conditioning credit on the purchasing of other services?

The staff of the subcommittee wishes to express its special appreciation to Peter J. Wallison, General Counsel of the Treasury, and Raymond Natter of the Congressional Research Service for their recent publications on many of the above subjects and from whose work the staff of the subcommittee has all too frequently borrowed, without the appropriate, scholarly attribution, in the preparation of these interrogatories.

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

July 15, 1983

The Honorable Ronnie G. Flippo
House of Representatives
Washington, D. C. 20515

Dear Mr. Flippo:

Thank you for your letter of July 11 requesting comment on correspondence you received from Ms. Nancy B. Greist regarding the Federal Reserve System.

The Federal Reserve System--the nation's central bank--was established by an Act of Congress in 1913. It is made up of twelve regional Federal Reserve Banks which are supervised by the Board of Governors in Washington. The Reserve Banks are corporate instrumentalities of the United States, and were established by Congress for public purposes.

The Board is an agency of the Federal Government, and its seven members are appointed by the President with the advice and consent of the Senate. As Ms. Greist requested, I am pleased to enclose biographical sketches of the present members of the Board of Governors. The salaries of Board members are established by statute. Chairman Volcker receives $69,800 per annum and the other six members of the Board receive $68,400 per annum.

The Congress has ultimate authority over the Federal Reserve and oversees the activities of the System through relevant committees. The general goals of the Federal Reserve have been set forth in the Full Employment and Balanced Growth Act of 1978, in which Congress laid out for the Federal Reserve, as well as for the President, the directives of promoting full employment, balanced growth of real income, adequate productivity growth, and reasonable price stability. Moreover, the Board is required by law to make an annual report to the Congress and members of the Board, especially the Chairman, are called upon frequently to testify before Congressional committees.

The Federal Reserve is not operated for a profit and returns substantial sums to the U.S. Treasury each year. The earnings of the Federal Reserve System are derived chiefly from interest on U.S. Government securities held in the System's Open Market Account, which are acquired as a part of the System's monetary policy actions. The System returns all earnings in excess of expenses to the U.S. Treasury; in calendar year 1982 payments to the Treasury by the Federal Reserve amounted to more than $15 billion.

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Federal Reserve Bank of St. Louis

As provided for by law, the stock of the Federal Reserve Banks is held entirely by the more than 5,000 commercial banks that are members of the Federal Reserve System. In addition to state-chartered member banks, which have voluntarily joined the Federal Reserve System, all national banks, which are chartered by the Comptroller of the Currency, an official of the Department of the Treasury, are required by law to be members of the System. These banks hold the stock of the Federal Reserve Banks. However, ownership of that stock is in the nature of an obligation incident to membership and does not carry with it the attributes of control and financial interest ordinarily attached to stock ownership in corporations that are operated for the purpose of making a profit. As provided in the Federal Reserve Act (Section 5), each commercial bank that is a member of the Federal Reserve System is required to subscribe to the stock of its Federal Reserve Bank in an amount equal to 6 percent of the paid-up capital stock and surplus of the member bank. Of the 6 percent subscription required, half (or 3 percent) is paid in, and half is subject to call. The stock may not be sold or pledged as security for loans, and dividends are limited by law to 6 percent per annum. The Federal Reserve Act also provides that any surplus resulting from the liquidation of a Federal Reserve Bank shall be paid to the United States Government, and not the stockholding member banks.

As further background on the System, I am enclosing five pamphlets on the structure of the Federal Reserve System, which may be of interest to Ms. Greist.

I hope this information is helpful. Please let me know if I can be of further assistance.

Sincerely,

(Signed) Donald J. Winn

Donald J. Winn
Assistant to the Board

Enclosures

CO:vcd (V-131)
bcc: Mrs. Mallardi

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Federal Reserve Bank of St. Louis

RONNIE G. FLIPPO
5TH DISTRICT, ALABAMA

COUNTIES:
COLBERT, JACKSON,
LAUDERDALE, LAWRENCE,
LIMESTONE, MADISON,
MORGAN

405 CANNON BUILDING
WASHINGTON, D.C. 20515

COMMITTEE:
WAYS AND MEANS

Congress of the United States
House of Representatives
Washington, D.C. 20515

July 11, 1983

#131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 JUL 14 PM 2: 29
RECEIVED
OFFICE OF THE CHAIRMAN

Mr. Paul A. Volcker
Chairman, Board of Governors
Federal Reserve System
Constitution Avenue and 21st Street
Washington, D.C. 20551

Dear Mr. Volcker:

Attached is a letter which I received from Ms. Nancy B. Greist of Huntsville, Alabama, asking several questions about the Federal Reserve System. I would greatly appreciate your providing me with any available information so that I may respond to her inquiry.

Thank you very much for your time and consideration in this regard.

Sincerely,

Ronnie G. Flippo

Ronnie G. Flippo

F:dg
Enclosure

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Federal Reserve Bank of St. Louis

June 23, 1983

Ronnie Flippo
P O Box 6665
Huntsville, Ala.

Good Morning Mr. Flippo

As we approach another fourth of July holiday that celebrates the independence of this great nation, I find myself, along with a large group of my friends, ignorant of some facts regarding the Federal Reserve System.

The group has asked me to write and ask if you will kindly take a moment of your time to enlighten us.

1. What is the Federal Reserve System?

2. Who are the individuals (by name) that make-up this system?

3. How are these individuals appointed to their positions?

4. How much are they paid?

5. Are they in any way regulated by the President, the Congress and/or by the U.S. voters?

6. What part of the U.S. Constitution compels the U.S. citizenry to abide by the policies issued by this system?

We wait, most assuredly, with interest for your response, as we are all getting "curiouser and curiouser".

Sincerely,

Nancy B. Grejst

Nancy B. Grejst
and friends

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Federal Reserve Bank of St. Louis

July 15, 1983

The Honorable Fernand J. St Germain
Chairman
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance
Committee on Banking, Finance and
Urban Affairs
House of Representatives
Washington, D. C. 20515

Dear Chairman St Germain:

Thank you for your letter of June 13 asking that we keep you and the members of your Subcommittee informed regarding the Board's deliberations on the Community Reinvestment Act ("CRA")-related recommendations made by the Center for Community Change.

Because we had not received a copy of the Center for Community Change's report referred to in your letter, we contacted a staff member of that organization, who informed us that the document they sent you is not a separate report prepared by the Center, but simply the preliminary report of the Consumer Advisory Council.

As you may know, I had asked our Consumer Advisory Council to review and evaluate the Board's implementation of the CRA. The Council has completed its field work and presented its preliminary report at its March 1983 meeting. The draft report will be discussed again at the upcoming July 21 meeting. I will be happy to share the Council's report with you, as well as information on actions the System takes in response to the report.

Sincerely,

JCK:JWL:AFC:vcd (V-103)
bcc: Mr. Kluckman
Mr. Lowell
Mrs. Mallardi (2)

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Federal Reserve Bank of St. Louis

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

July 15, 1983

The Honorable David O'B. Martin
House of Representatives
Washington, D. C. 20515

Dear Mr. Martin:

Thank you for your recent correspondence requesting comment on the enclosed correspondence from Mr. Joseph W. Dufort, Director of the Franklin County Veterans Service Agency in Malone, New York. Mr. Dufort wrote that he had been contacted by Mr. William Mitchell concerning Mr. Mitchell's inability to obtain financing to build a home on land located on the St. Regis Mohawk Reservation. Mr. Dufort states that the reason given by several lending institutions in his area for the credit denial is that they cannot foreclose or repossess land which is situated on the reservation. Although Mr. Dufort believes that this may be a legitimate concern for lenders to consider, he indicates his belief that such a practice is discriminatory and asks what financing options are available to persons such as Mr. Mitchell.

The Equal Credit Opportunity Act and its implementing Regulation B prohibit discrimination in lending on the basis of race, color, age, sex, marital status, religion, national origin, because a person is a recipient of public funds, or because a person exercises his or her rights under the Consumer Credit Protection Act. Lenders, however, have a great deal of flexibility in establishing criteria for the types of loans they will make and the creditworthiness of the persons to whom they will lend. Their standards may include such things as level of income, the value of assets owned, the amount of debts owned, the length of residency, and so on. It is permissible for lenders to set these standards as long as they do not discriminate against a protected class.

Clearly, the relationship between the dictates of the Equal Credit Opportunity Act and creditors' needs for secure collateral is not always an easy thing to sort out in the context of American Indians who live on reservations and also need credit. In general, the Act and Regulation B prohibit a creditor from having a general lending policy which refuses to grant credit to any American Indian or to any person who lives on an American Indian Reservation. Furthermore, creditors may not have a general lending policy which refuses to grant credit to any person simply because the security offered is property located on an American Indian Reservation. Creditors, however, may refuse to grant credit if the refusal is based on nonracial considerations such as the availability of legal rights, remedies or procedures in the event of default by the borrower, the

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marketability of loans in the secondary market, and the qualifications or criteria for participation in governmentally-insured or guaranteed programs.

As we understand it, property on American Indian Reservations is often beyond the reach of the jurisdiction of this country's normal court processes. Apparently, however, some tribal councils offer redress in tribal courts to outside creditors. At least one federal district court has approved an agreement between the U.S. Justice Department and a creditor, which outlines the principle that the creditor must take some steps to investigate the availability and reliability of tribal court processes before it decides whether or not to grant credit to American Indians.

In order to facilitate private credit granting to American Indians in his area in the future, Mr. Dufort might wish to approach the local lending institutions and tribes with the aim of seeing whether such a principle would work. Furthermore, staff at the Bureau of Indian Affairs of the Department of the Interior suggested that Mr. Dufort and Mr. Mitchell contact the Bureau of Indian Affairs Office in Syracuse, New York. The address of this office is noted below. Apparently, Mr. Mitchell's problem is not unique and federal programs exist to deal with such situations.

I hope this information is helpful. Please let me know if I may be of further assistance.

Sincerely,

(Signed) Donald J. Winn

Donald J. Winn
Assistant to the Board

Enclosure

SP:WRM:vcd (#V-100) bcc: Ms. Potkai, Mrs. Mallardi

Bureau of Indian Affairs Office
Federal Building
100 South Clinton Street
Syracuse, New York 13202
Phone: (315) 423-5476

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Action assigned Mr. Garwood

DAVID O'B MARTIN
26TH DISTRICT, NEW YORK

COMMITTEE ON
ARMED SERVICES

Congress of the United States
House of Representatives
Washington, D.C. 20515

#100

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 JUN 10 AM 11: 22
RECEIVED
OFFICE OF THE CHAIRMAN

June 8, 1983

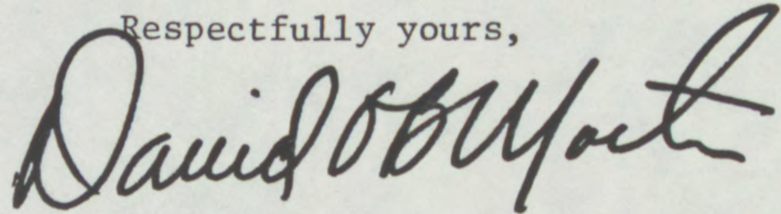
Paul A. Volcker, Chairman
Federal Reserve System
20th and Constitution Avenue, N.W.
Washington, D. C. 20551

Dear Mr. Volcker:

Enclosed you will find a copy of the correspondence I have received from Mr. Joseph W. Dufort, the Director of the Franklin County Veterans Service Agency in Malone, New York. As you will note, he is concerned over the fact that an American Indian, who is entitled to a Veterans Administration Home Loan Guarantee, has been unsuccessful in his attempts to locate a private lending institution which is willing to approve a mortgage application since the property he wishes to purchase is on the St. Regis Mohawk Indian Reservation.

I would appreciate your reviewing this matter and furnishing me with a detailed response upon which I may base a reply to my constituent.

Respectfully yours,



David O'B. Martin
Member of Congress

DM/jh
Enclosure (1)

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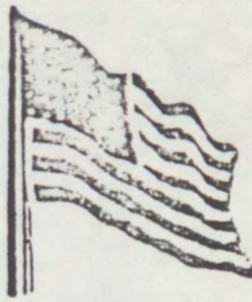

FRANKLIN COUNTY VETERANS SERVICE AGENCY

NEW YORK STATE DIVISION OF VETERANS AFFAIRS

Phone 518-483-6767 89 West Main Street Malone, New York 12953
Ext. 393 or 394

3 June, 1983

RECEIVED
JUN 7 1983

Congressman David O'B. Martin
Room 502
Cannon House Office Building
Washington, D.C. 20515

Dear Congressman Martin,

Once again I am seeking your assistance in a Veteran-related problem which I have recently become cognizant of.

I was contacted by a Native American, Mr. William, Mitchell, in regards to the Veterans Administration Home Loan Guarantee Program. This Honorably Discharged, Viet Nam Veteran has tried to obtain financing through various North Country lending institutions and has been unsuccessful. He and his wife are both employed and their ability to repay a loan has not been questioned. They have been refused loans at these lending institutions because the porperty on which they wish to build is located on the St. Regis Mohawk Reservation. The reasoning behind the credit denial is that the lending institution cannot foreclose or repossess land which is situated on the Reserve.

This may be a legitimate concern for the lenders to consider, however, where does this leave these persons who wish to make adequate arrangements for their homes? There is a Credit Union located on the Reserve but this Credit Union does not have the capital to make home loans. My position as Director of the Franklin County Veterans Service Agency requires me to assist Veterans in obtaining those benefits to which they are legally entitled to. I am quite sure that you realize how frustrating this situation has become for me to deal with.

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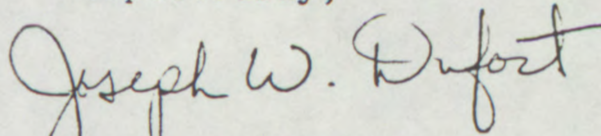
Mr. Mitchell was the first person from the Reserve who made me aware of this problem and I feel it is my duty to seek assistance to alleviate or rectify this problem before I am confronted with it again. Refusing credit for lands or dwellings located on the Reserve appears to be discriminatory. I have morally pledged myself to do everything possible to help these Native Americans. Any Assistance you may lend will be greatly appreciated. If there are any questions you may want to ask or any information I can provide, please contact me at your convenience. Awaiting your kind reply, I remain,

Respectfully,



Joseph W. Dufort
Director

JWD:jb

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Federal Reserve Bank of St. Louis

July 13, 1983

The Honorable Jake Garn
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Chairman Garn:

Thank you for your letter of July 13 concerning my testimony on monetary policy pursuant to the Full Employment and Balanced Growth Act of 1978.

I look forward to appearing before your Committee on July 21 at 9:30 a.m.

Sincerely,

S/ Paul

vcd (V-128)

bcc: Messrs. Axilrod, Kichline, Prell
Mrs. Mallardi (2)

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Mrs. Mallardi

cc: Messrs. Axilrod, Kichline, Prell

JAKE GARN, UTAH, CHAIRMAN

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United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

July 13, 1983

The Honorable Paul A. Volcker
Chairman
Federal Reserve Board
20th and C Streets, N.W.
Washington, D.C. 20551

Dear Mr. Chairman:

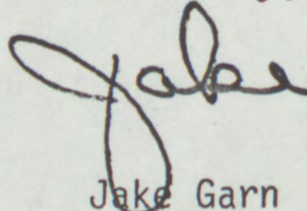
The purpose of this letter is to request that you appear before the Senate Committee on Banking, Housing, and Urban Affairs on Thursday, July 21, 1983, to present the Board of Governors' "Midyear Monetary Policy Report to the Congress" pursuant to the requirements of the Full Employment and Balanced Growth Act of 1978.

This hearing will also consider the appropriate response to Section 6 of the Conference Report on the First Budget Resolution for Fiscal Year 1984 requesting a Senate resolution on the "coordination" of monetary and fiscal policies and on other issues.

In particular, the Committee would be interested in a discussion of how the Federal Reserve formulates monetary policy, the type of economic assumptions and/or goals that are used in the formulation of monetary policy, the way the fiscal policy position of the federal government is incorporated in monetary policy formulation, and how the Federal Reserve's economic assumptions and/or goals might be used by the Congress in the formulation of fiscal policy.

This hearing will be held in Room SD-538 of the Dirksen Senate Office Building and will begin at 9:30 a.m.

Sincerely,



Jake Garn
Chairman

JG/lsh

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Federal Reserve Bank of St. Louis

July 13, 1983

The Honorable Fortney H. Stark
House of Representatives
Washington, D. C. 20515

Dear Pete:

Thank you for your letter of June 24 giving me the opportunity to comment on the Federal Reserve System study entitled, "Public Policy and Capital Formation".

The authors of the staff study argued that the existing capital stock was not efficiently allocated for a number of reasons. Among them were the facts that (1) the implicit income from household capital (the implicit rent on owner-occupied housing and consumer durables) is not taxed while the income arising from business capital is taxed; and (2) business income subject to tax was overstated because inflation reduced the real value of that portion of depreciation allowances that are taken some time after the installation of the plant or equipment which gave rise to them.

The increases in investment tax credits and the net acceleration of depreciation allowances resulting from ERTA and TEFRA have substantially reduced the intersectoral bias of the tax code. The improved inflation outlook since 1981 also has contributed to lowering the cost of business capital by raising the real value of depreciation deductions from taxes. Consequently, while it must be recognized that the tax code cannot possibly be structured to be completely neutral between different types of investments, the forces cited in the staff study that tend to bias investment toward household capital seem much reduced.

In contrast, however, when the staff study was written the Federal budget on a structural basis was nearly in balance. Unfortunately, federal structural deficits currently and in prospect are sufficiently large to absorb a substantial portion of private saving. Unless this situation is corrected, domestic capital formation seems likely to fall short of desirable levels. I believe it most important to bring federal receipts and outlays into better alignment, and very much support your efforts in this regard.

I hope you find these comments useful. Please let me know if I can be of further assistance.

Sincerely,

SL:JE:CO:vcd (V-114)
bcc: Ms. Lepper
Mr. Enzler
Ms. Wing
Mrs. Mallardi (2)

S/ Paul

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Federal Reserve Bank of St. Louis

FORTNEY H. (PETE) STARK
9TH DISTRICT, CALIFORNIA

Action assigned Mr. Kichline

COMMITTEES:
WAYS AND MEANS
DISTRICT OF COLUMBIA
SELECT NARCOTICS

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
WASHINGTON, D.C. 20515

June 24, 1983

#114

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 JUN 28 AM 9: 11
RECEIVED
OFFICE OF THE CHAIRMAN

Hon. Paul Volcker
Chairman
Federal Reserve Board
Constitution Avenue & 21st Street, N.W.
Washington, D. C. 20551

Dear Mr. Chairman:

I recently encountered a quote from your 1981 study, "Public Policy and Capital Formation," which read

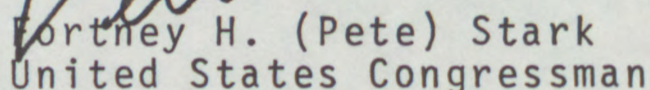
> "While finding that the overall rate of capital formation is probably adequate, this study concludes that the existing capital stock is misallocated, probably seriously, among sectors of the economy and types of capital, primarily because of distortions caused by inflation and U.S. tax laws.... The biases are substantial.... As a result, capital is not applied to its most efficient uses....The cost to the nation has been lessened productivity growth and reduced business output."

The Ways and Means Committee has been ordered by the budget process to raise over $10 billion in new revenues for FY 1984--thus we are about to have our third major tax bill in three years.

It would be helpful if, prior to the mark-up on this summer's tax bill, you could comment on whether you feel the above 1981 quote is still accurate, and whether the last two tax bills (ERTA & TEFRA) have increased or decreased the investment biases.

Thank you for your assistance in this request.

Sincerely,



Fortney H. (Pete) Stark
United States Congressman

FHS:wkv

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Federal Reserve Bank of St. Louis

July 13, 1983

The Honorable Fernand J. St Germain
Chairman
Committee on Banking, Finance and
Urban Affairs
House of Representatives
Washington, D. C. 20515

Dear Chairman St Germain:

Thank you for your letter of July 11 concerning my testimony on monetary policy pursuant to the Full Employment and Balanced Growth Act of 1978.

I look forward to appearing before your Committee on July 20 at 10:00 a.m.

Sincerely,

PJT:vcd (V-125)

bcc: Mr. Axilrod
Mr. Kichline
Mr. Prell
Mrs. Mallardi (2)

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Federal Reserve Bank of St. Louis

Copies to Messrs. Axilrod, Kichline & Prell.

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U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

NINETY-EIGHTH CONGRESS

2129 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, D.C. 20515

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DAVID DREIER, CALIF.
JOHN HILER, IND.
THOMAS J. RIDGE, PA.
STEVE BARTLETT, TEX.

225-4247

July 11, 1983

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 JUL 12 PM 12: 03
RECEIVED
OFFICE OF THE CHAIRMAN

Chairman Paul Volcker
Federal Reserve Board
20th & Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Chairman Volcker:

Under the Humphrey-Hawkins Act, you are required to report to Congress on the monetary policy plans for the remainder of this year and on preliminary plans for 1984. Your testimony should be delivered in person on July 20th, 1983 beginning at 10 a.m. 150 copies of the report from the Federal Open Market Committee and the Board of Governors should be presented to the Committee no later than 10 a.m. on July 19, 1983, in accordance with Committee rules. Please include 150 copies of this report.

In addition to the normal Humphrey-Hawkins requirements, I believe the Committee needs to hear from you about several important questions on the future of monetary policy. These answers should be provided with your written statement. The questions are:

(1) Can we identify a particular conception of "money" with sufficient precision to allow its use as a proxy for economic performance? Is there any definable "money" or "credit" with a stable relationship to GNP, inflation and unemployment?

(2) There has been an undeniable breakdown in the standard "velocity" growth assumptions. Is this a short-term phenomenon or does it reflect a breakdown in money definitions/money relationships that will render the standard monetary equations unusable in coming years?

(3) It is widely believed that the Federal Reserve Board should begin to set and announce its objectives for nominal and/or real GNP, inflation and unemployment. Do you agree with this sentiment? Would you prefer to offer "estimates" for these variables rather than "objectives"?

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Federal Reserve Bank of St. Louis

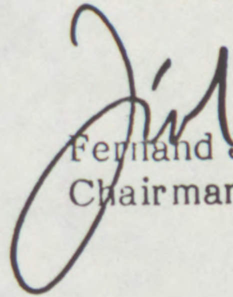
(4) Should U.S. monetary policy be formally or informally coordinated with the monetary policies of our major trading partners, and/or should the U.S. move toward adoption of a multilateral exchange rate stabilization process?

My final concern is with the format of your Monetary Policy Reports. The organization of these reports unnecessarily detracts from the importance of your economic outlook for the future. Therefore, I request the following changes be made in your Report to the House Banking Committee this July. First, the Economic Outlook section should be the first section of your Report, followed by the section detailing your Objectives for the Growth of Money and Credit, and finally should come the section in the period just passed. Second, the first page of the first section should consist of only a table given the FOMC economic assumptions, in the central tendency form you adopted last report.

Since your Report is meant to be a Report to this Committee, for the use of this Committee, I am sure that you will agree to changes suggested by the Committee to improve our understanding and analysis of your Report.

I am looking foward to your statement, report and testimony.

Sincerely,



Fernand J. St Germain
Chairman

FJStG:dMh

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Federal Reserve Bank of St. Louis

July 12, 1983

The Honorable Steny H. Hoyer
House of Representatives
Washington, D.C. 20515

Dear Steny:

Thank you for your recent letter on behalf of Mr. Richard Alper, who has expressed an interest in employment with the Board of Governors.

I have asked our Division of Personnel to contact Mr. Alper directly regarding his candidacy for positions with the Board.

Let me assure you that his background of training and experience will be given careful consideration for all appropriate positions which are to be filled now or in the near future.

We appreciate having your recommendation on behalf of Mr. Alper.

Sincerely,

KW:CO:pjt (#V-118)
bcc: Ms. Warehime
Mrs. Mallardi (2)

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Federal Reserve Bank of St. Louis

July 12, 1983

The Honorable Steny H. Hoyer
House of Representatives
Washington, D.C. 20515

Dear Steny:

Thank you for your recent letter on behalf of Mr. Richard Alper, who has expressed an interest in employment with the Board of Governors.

I have asked our Division of Personnel to contact Mr. Alper directly regarding his candidacy for positions with the Board.

Let me assure you that his background of training and experience will be given careful consideration for all appropriate positions which are to be filled now or in the near future.

We appreciate having your recommendation on behalf of Mr. Alper.

Sincerely,

S/ Paul

KW:CO:pjt (#V-118)
bcc: Ms. Warehime
Mrs. Mallardi (2)

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Action assigned Mr. Shannon

Congress of the United States
House of Representatives
Washington, D.C. 20515

STENY H. HOYER
5TH DISTRICT, MARYLAND

COMMITTEES:
POST OFFICE AND CIVIL SERVICE
BANKING, FINANCE AND URBAN AFFAIRS

June 27, 1983 #118

Mr. Paul Volcker
Federal Reserve Board
20th and C Streets, N.W.
Washington, D.C. 20551

Dear Paul,

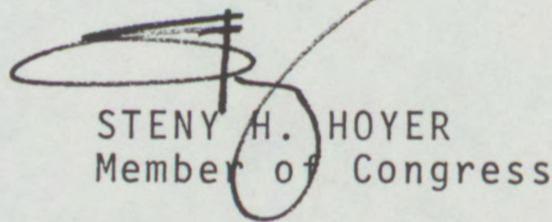
I am enclosing a copy of a resume of a young attorney, Richard Alper, who is very interested in attaining a position at the Federal Reserve Board.

I have known Richard for sometime and he has an outstanding record of achievement. He has done an excellent job in the past in negotiating and litigating for Prince George's County and has proven himself more than capable in handling a variety of legal matters.

Richard is a fine young man who I feel would be a definite asset to your agency. I hope you will consider him for any position that may be available.

Thanking you for your consideration and with kindest regards, I am

Sincerely yours,



STENY H. HOYER
Member of Congress

enclosure

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Citations: Resume, Richard S. Alper, 1983.

July 8, 1983

The Honorable Don Sundquist
House of Representatives
Washington, D. C. 20515

Dear Mr. Sundquist:

Thank you for your letter of June 28 regarding the membership application of Central Trust Company, Memphis, Tennessee (Central). Although the Board's staff letter of June 24 to Mr. Kenneth Lenoir, President of Central, indicated staff's willingness to present the application to the Board for consideration, it also pointed out concerns that staff believed could be addressed to give Central's application, which is unique in relation to previous applications in several respects, a better chance of approval. As you have been informed, one of staff's opinions was that the expected expansion of Central's activities should be accompanied with a strong capital position, at least in the amount required by state banking law. A capital position of this nature would also alleviate the inequalities between Central and other state-chartered member institutions.

Board staff on several occasions have discussed these concerns and opinions with Mr. Lenoir by telephone. Mr. Lenoir has subsequently provided staff with a letter dated July 6, 1983, in which he has delineated a proposal to augment Central's capital position. Staff is currently in the process of reviewing the proposal and has contacted Mr. Lenoir by telephone in our continuing efforts to process Central's application for membership.

We hope that this information is responsive to your concerns regarding Central's membership application.

Sincerely,

(Signed) Donald J. Winn

Donald J. Winn
Assistant to the Board

DRV:CO:vcd (V-115)
bcc: Don Vinnedge
Jack Egertson
Bill Taylor
Mrs. Mallardi

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DON SUNDQUIST
7TH DISTRICT, TENNESSEE

COMMITTEES:
PUBLIC WORKS AND TRANSPORTATION
VETERANS AFFAIRS

WASHINGTON OFFICE:
515 CANNON HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515
202-225-2811

Action assigned Mr. Ryan; info copy to Mr. Bradfield

DISTRICT OFFICES:
117 SOUTH 2ND STREET
CLARKSVILLE, TENNESSEE 37040
615-552-4406

5909 SHELBY OAKS DRIVE
SUITE 112
MEMPHIS, TENNESSEE 38134
901-382-5811

Congress of the United States
House of Representatives
Washington, D.C. 20515

June 28, 1983

#115

The Honorable Paul A. Volcker
Federal Reserve System
Twentieth Street and Constitution Avenue NW
Washington, D. C. 20551

Dear Mr. Chairman:

The Central Trust Company of Memphis, Tennessee made application March 21, 1983 in St. Louis, Missouri to become a member of the Federal Reserve. This company has been in successful business for eleven years and handles more trust and retirement funds than all of the Memphis banks combined.

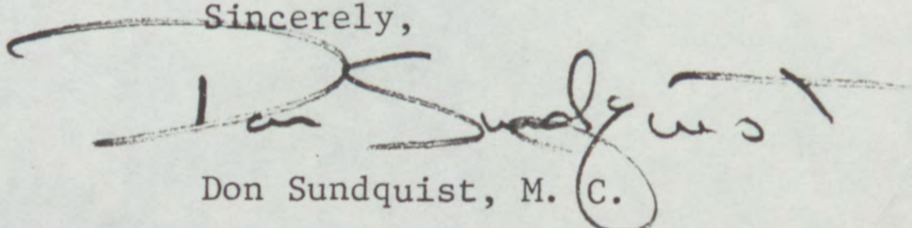
It is my understanding that Central Trust has not been refused membership to date, however the capital requirements have been placed so high that membership is unlikely. The company has agreed to a $250,000 capital requirement level, yet the Federal Reserve has set the level at $500,000. It appears that the capital requirement level is arbitrary and unnecessary. It should be noted that the state banking law in Tennessee only requires a $300,000 level.

Central Trust would certainly agree to some long term capital program or some retained earnings program, which to me would appear to be a satisfactory solution.

As you know, your letter to Central Trust was dated June 24, and their options close ten days after that date. Therefore, an expeditious reply to this letter is necessary to meet that deadline.

Thank you for your assistance.

Sincerely,



Don Sundquist, M. C.

DKS/ky

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DON SUNDQUIST
7TH DISTRICT, TENNESSEE

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Congress of the United States
House of Representatives
Washington, D.C. 20515

June 28, 1983

#115

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Twentieth Street and Constitution Avenue NW
Washington, D. C. 20551

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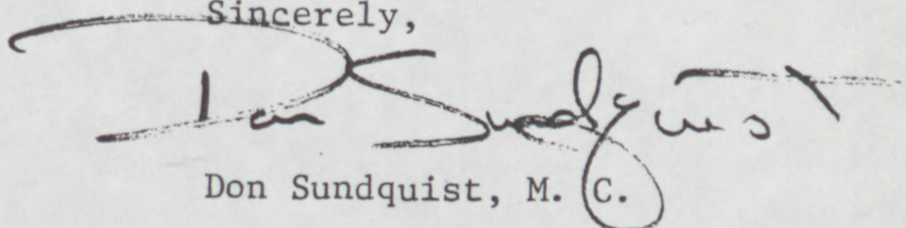

Don Sundquist, M. C.

DKS/ky

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July 6, 1983

The Honorable Bill Gradison
House of Representatives
Washington, D.C. 20515

Dear Bill:

I read your remarks with interest, but I better not try to respond in depth now, given that the general subject is bound to come up in hearings over coming weeks.

Certainly, I sympathize with your point, but a lot depends on just what people mean by an "accord." Obviously, I am very wary of suggesting, or agreeing to, approaches that imply more omnipotence than we have.

Sincerely,

PAV:pjt (#V-113)
bcc: Mrs. Mallardi (2)

Chairman Volcker added a P.S.: "Let's have breakfast some day."

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Action assigned Mr. Kichline; info copy to Mr. Axilrod

BILL GRADISON
2ND DISTRICT, OHIO

MARGARET TOTTEN
ADMINISTRATIVE ASSISTANT

Congress of the United States
House of Representatives
Washington, D.C. 20515

2311 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-3164

FEDERAL OFFICE BUILDING
550 MAIN STREET
CINCINNATI, OHIO 45202
TELEPHONE: (513) 684-2456

190 EAST MAIN STREET
BATAVIA, OHIO 45103
TELEPHONE: (513) 732-1786

Chairman - you should look at this before ~~next~~ the July 14 hearing.

June 24, 1983

Paul Volcker
Chairman
Federal Reserve
20th and C Streets, NW
Washington, D.C. 20551

Dear Paul:

Here's a piece I put together about the need for a more cooperative--less confrontational--relation between the Fed and the Congress. I believe you have a far better chance than the President to encourage the Congress to act now to head off the dire consequences of large outyear deficits.

Hope you find this of some help.

Sincerely,

Bill

Bill Gradison
Representative in Congress

BG/a

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BILL GRADISON
2ND DISTRICT, OHIO

MARGARET TOTTEN
ADMINISTRATIVE ASSISTANT

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House of Representatives
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June 24, 1983

Paul Volcker
Chairman
Federal Reserve
20th and C Streets, NW
Washington, D.C. 20551

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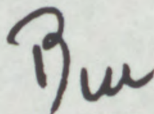

Bill Gradison
Representative in Congress

BG/a

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highly sophisticated social structure, perhaps the nearest approach to human civilization in the insect world.

Other advantages include their hard external skeletons, able to withstand the rigors of lift-off and added gravity, their ability to live in confined spaces with minimal life-support mechanisms, and their ciliated feet which can cling to smooth surfaces, even in the absence of gravity.

The carpenter ants, among the hardiest and largest type ants found in North America, have the ability to withstand wide variations in temperature and for their size (as long as a half inch) which makes them easy to observe. The four-month average lifespan of the carpenter ant makes it likely that birth, death and other major events in the ants' life-cycle will occur during the Space Shuttle's one-week voyage.

RCA'S ROLE

RCA paid NASA's $10,000 fee for the Orbit '81 space aboard the space shuttle.

Engineers from RCA plants and the staff of RCA's Government and Commercial Systems Divisions have lectured students on computers, computer software, amateur radio satellite terminals, and electronic test equipment.

Students have taken several field trips to RCA plants and Laboratory in southern New Jersey (Princeton, Camden and Moorestown).

RCA engineers have served on technical advisory committee for the students' design of the experiment. In addition, the RCA divisions have donated more than $450,000 worth of surplus electronic test equipment to both high schools.

In addition, the mircroprocessor that will control the experiment's equipment was donated by RCA as was the consumer grade video camera and recorder that will document the ants' space voyage.

RCA Solid State Division, Consumer Products Division and RCA Service Company have donated new equipment, advice and services on a continuing basis throughout the training and development cycle of the Orbit '81 project.

CHRONOLOGY

November 1977: Project conceived at a meeting of NASA officials and community leaders. RCA offers to pay $10,000 NASA fee for small experimental payloads aboard the shuttle.

January 1978: Camden Board of Education endorses and approves a program that will put a student experiment in space.

Summer of 1978: School administrators and teachers start to develop science curricula, aided by a grant from RCA and the Camden School Board.

May 1979: Students select ant colony as the subject for experiment.

July 1979: NASA deems experiment significant and approves.

February 1980: Dr. Robert Frosch, NASA administrator, visits schools and deems Orbit '81 a role model for other high school programs designing experiments for the space shuttle.

October 1981: Students' design for experiment approved by panel of RCA engineers and biology professor John Tarka of Temple University, Philadelphia.

May 1982: Students complete construction of experiment. Tests scheduled at RCA facility in Princeton, N.J.

September 1982: Students began improvements to the experiment based on advances in the state of the Art.

April 1983: Students complete preparation of the experiment at Kennedy Space Center for loading aboard STS-7.●

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from Arkansas (Mr. ALEXANDER) is recognized for 60 minutes.

[Mr. ALEXANDER addressed the House. His remarks will appear hereafter in the Extensions of Remarks.]

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from California (Mr. DANNEMEYER) is recognized for 30 minutes.

[Mr. DANNEMEYER addressed the House. His remarks will appear hereafter in the Extensions of Remarks.]

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from Pennsylvania (Mr. GEKAS) is recognized for 15 minutes.

[Mr. GEKAS addressed the House. His remarks will appear hereafter in the Extensions of Remarks.]

ACCORD BETWEEN CONGRESS AND THE FED NEEDED

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from Ohio (Mr. GRADISON) is recognized for 5 minutes.

● Mr. GRADISON. Mr. Speaker, now that the question of the leadership of the Federal Reserve has been settled, we can turn our attention to the job we want the Fed to perform, and how Congress can work in concert with the Fed to meet joint objectives. The Fed has something Congress wants: lower interest rates. And we have something they need to do their job: control over fiscal policy. Our highest priority should be given to working cooperatively with the Fed rather than acting like adversaries, with fiscal policy and monetary policy pulling in opposite directions.

There is precedent for such action. Once before the policies of the Federal Reserve were under attack, its treasured independence threatened; the Fed was at loggerheads with another branch of Government; and fear of future inflation was a pervasive concern. This was in 1951, when disagreement between the Treasury and the Fed broke into public view over the Treasury's desire to peg the price of U.S. bonds and the Fed's concern about inflationary increases in the money supply. Out of this controversy came the "Accord of March 4, 1951":

> The Treasury and the Federal Reserve System have reached full accord with respect to debt management and monetary policies to be pursued in furthering their common purpose to assure the successful financing of the Government's requirements and, at the same time, to minimize monetarization of the public debt.

Now the Fed and the Congress are at odds over clashes between monetary and fiscal policies. There is fear that the recovery may be dampened or even reversed by rising interest rates caused by competition for funds between a reviving private sector and a deficit-laden Federal Government. Congress wants to know in advance, and with specificity, the Fed's "objectives" for GNP, inflation, and unemployment.

The Fed argues that establishing short-term objectives for these variables would encourage undesirable "fine tuning," place too much emphasis on short-term economic events, and mislead the public into believing that monetary policy can relieve the need for difficult choices on the budget and other areas of economic policy.

While public debate is focused on this disagreement, the basic issue of how to have compatible monetary and fiscal policies remains unresolved.

There is need for a new accord, this time between Congress and the Fed, to define their proper roles in laying the basis for a sustained, noninflationary recovery. There is no more important task for the Fed, if its hard-won gains against inflation are to be preserved, and no greater challenge for the Congress, if the nearly unanimous concern of its Members about large outyear deficits is to be translated into deficit-reducing actions.

The key elements of the 1983 accord should be:

First, a commitment by the Fed not to use its power to influence the money supply and short-term interest rates in a manner that chokes off economic recovery.

Second, credible action by the Congress to reduce the deficit to below 2 percent of GNP by fiscal year 1987; and

Third, a public statement by the Fed and congressional leaders in support of the accord.

Because so much attention has focused on who should chair the Fed, a primary task facing the agency has been given inadequate attention. I am suggesting that the Chairman's goal should not be to make the White House happy, or to satisfy foreign central banks, comfort big city bankers, or reassure the money markets. Instead, the Chairman should strive to mend the tattered Fed-Congress relationship by developing with Congress an accord that will result in lower deficits and a better mix of monetary and fiscal policy.

The accord would aid Congress by assuring that the politically painful steps necessary to reduce the deficit would not be made politically disastrous by a monetary policy that would abort the recovery. Likewise, the accord would give the Fed the assurance that fiscal policy would be such that it could safely pursue a moderate monetary policy.

Without such an agreement, Congress and the Fed risk a continued confrontation that will hinder, if not stifle, economic growth. In the absence of positive action by Congress to reduce deficits, the Fed would likely choose one of two tacks: Either pursue a tight money policy in an attempt to

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offset stimulative fiscal policy, or pursue a loose money policy in order to accommodate fiscal policy. In either case, the result would be high interest rates and sluggish or negative growth—and further attacks on Congress for ineptitude in reducing deficits and on the Fed's independence, as each continues to blame the other.

Can an accord be reached? Is there anything the Congress—given its track record—can do to convince the Fed and an understandably skeptical public that it will not permit outyear deficits?

I believe there is. It first requires agreement not only that there is a problem, but also that action is needed now to solve that problem; put another way, that it is more likely that economic growth will be stifled by continuing large deficits than it is that economic growth will bring the deficits down to manageable size.

Second, it requires acknowledgement of the political standoff which exists between those who would deal with deficits by cutting spending and those who would deal with deficits through higher taxes—including deferring tax cuts not yet effective. While members of each group see political advantages in their positions, neither side in this largely ideological war can win the really important battle; both spending restraint and increased revenues are politically necssary to substantially reduce the outyear deficits. The worst possible outcome would be for both the "more domestic spending" and the "no new taxes" forces in Congress to prevail, and go home proclaiming victory.

Finally, it requires action now—in 1983, not in the election-year context of 1984—on the major elements: reduction of the growth in defense spending and phased-in restraints on domestic spending programs—especially those benefitting the nonpoor—and increases in revenue.

Admittedly, it takes a leap of faith to believe that this accord can be achieved. But the stakes make it worth the try.●

THE HIGH TECHNOLOGY RESEARCH AND DEVELOPMENT JOINT VENTURE ACT OF 1983

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from Wisconsin (Mr. SENSENBRENNER) is recognized for 5 minutes.

● Mr. SENSENBRENNER. Mr. Speaker, I am introducing legislation jointly with the distinguished gentlewoman from Tennessee (Mrs. LLOYD) to help our Nation move forward in developing important new high technologies in such areas as semiconductor chips, microprocessors and supercomputers, sensors, chemical and material sciences, robotics, and alternative energy systems, among many others. This legislation, the High Technology Research and Development Joint Venture Act of 1983, would help our Nation maintain its world economic leadership and stimulate needed research and development activities. It would also have significant secondary benefits including the creation of new jobs, the growth of various support industries and the generation of additional tax revenues through increased economic activity.

As many of my colleagues are aware, our recent economic ills have been caused by several factors. One key factor, pointed out in various economic indicators, has been our country's notable decline in industrial productivity. While there have been impressive innovations in many of our basic industries, the overall rate of growth in America's industrial productivity slowed considerably during the 1970's. In fact, our domestic productivity actually declined a couple of points in 1981. This dangerous trend is one which our Nation cannot afford to tolerate and which must be reversed as soon as possible.

By many accounts our decline in productivity is representative of America's eroding technological leadership and lagging international competitiveness. This situation can be traced to more than a decade of low capital investment and limited R&D spending. Although the United States still leads the world in spending for basic research, a 1980 Harvard Business Review report pointed out that the private sector investment in research and development has been steadily decreasing in recent years with no changes foreseen in the future.

A recent study by the prestigious Business-Higher Education Forum has stressed the strong need to enhance our private industry's ability to compete with foreign ventures in developing and marketing new technologies. Without a firm commitment to basic research and development, our leadership in many new technological areas may be severely challenged in the future. For example, the Japanese are closing fast on the American lead in such areas as microchip technology, threatening U.S. preeminence in this important technology. These tiny electronic devices will be at the heart of our future advances in computers, communications, consumer products and many other areas.

The future challenge to America in technology development is awesome. International competitiveness has made it more difficult than ever to develop and exploit new inventions. It is certainly in our Nation's economic and national security interests to encourage new ideas and develop new technologies, allowing us to move forward and help lay the foundation for our future modern society.

The urgency of our present situation has been made clear in a recent report by a prestigious National Research Council panel. In its report entitled "International Competition in Advanced Technology: Decisions for America," this panel concluded that—

> The United States must act now to preserve its basic capacity to develop and use economically advanced technology. This innovative capacity is essential for the self-renewal and well-being of the economy and the nation's military security. Trade in advanced technology products and services will contribute enormously to our economic health. Advanced technology products and processes not only permeate the economy, increasing productivity, but also from the basis of modern defense hardware.

This report also went on to recommend that careful attention be given to "maintaining the health and effectiveness of both university- and industry-based research, education and training."

The legislation we are introducing today represents a significant step in meeting this national challenge. It recognizes that the most effective Federal actions to stimulate long-term private investments in research and development are those that remove potential structural barriers to such investment. This legislation attempts to overcome these institutional barriers and allow a wide range of businesses and firms to carry our productive research on a joint basis.

Several recent reports, including the previously mentioned National Research Council and Business-Higher Education Forum studies, have called for a relaxation in antitrust restrictions that presently hinder American industry's ability to take advantage of new high technologies. The National Research Council report strongly supported a careful reexamination of our antitrust policies, stating that—

> While U.S. antitrust policy has begun taking international competition into account, its implementation still fails to give sufficient weight to international trade considerations. The manner in which antitrust statutes are interpreted and applied is charged with interfering in international competitiveness. For example, firms have difficulty retaining the benefits of research that are the product of multifirm collaboration, prospective "safe—harbor" rulings are not readily available, and there is a general uncertainty regarding what corporate actions may elicit legal actions on the basis of anti-trust legislation.
>
> Because of this uncertainty, management cites anti-trust policy as creating excessive risk for a range of activities that may benefit innovation and trade, such as pooling research efforts, pooling information on the work of international competitors, or pooling development programs whose costs are too large for any one firm in an industry to undertake. By contrast, foreign governments—for example, Japan and France—encourage cooperation among firms through mergers or cooperative programs.

In essence, the legislation we are introducing today would provide new statutory guidelines for joint research and development ventures in order to determine whether these ventures were in compliance with Federal and similar State antitrust laws. These guidelines would also extend to any participant in the venture, as well as to all employees in the venture.

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July 12, 1983

The Honorable Paula Hawkins
Chairman
Subcommittee on Consumer Affairs
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Chairman Hawkins:

Thank you for your letter of June 27 concerning your Subcommittee's hearings on S. 1152, which would amend the Consumer Credit Protection Act.

Governor Nancy H. Teeters is looking forward to appearing before your Subcommittee, on behalf of the Board, on Tuesday, July 19, at 9:30 a.m.

Sincerely,

S/Paul A. Volcker

CO:DJW:vcd (V-116)

bcc: Gov. Teeters
Ellen Maland
Mrs. Mallardi (2)

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JAKE GARN, UTAH, CHAIRMAN

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JOHN HEINZ, PENNSYLVANIA
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JIM SASSER, TENNESSEE
FRANK R. LAUTENBERG, NEW JERSEY

M. DANNY WALL, STAFF DIRECTOR
KENNETH A. McLEAN, MINORITY STAFF DIRECTOR

United States Senate

COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, D.C. 20510

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June 27, 1983

Honorable Paul A. Volcker
Chairman
Federal Reserve Board
Washington, D.C. 20551

Dear Mr. Chairman:

This letter confirms the invitation of the Subcommittee on Consumer Affairs, Senate Committee on Banking, Housing and Urban Affairs for you to appear as a witness to offer testimony on S.1152, which would amend the Consumer Credit Protection Act. The hearing will be held on July 13, 1983, in Room SD-538 of the Dirksen Senate Office Building beginning at 9:30 a.m.

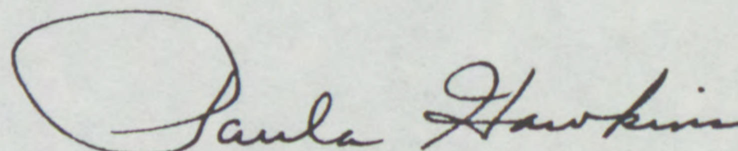
The purpose of the hearing is to determine whether consumer leasing provisions in Title I of the Consumer Credit Protection Act should be streamlined, as the Truth-in-Lending Act was simplified three years ago. The Subcommittee welcomes comments on the proposed consumer leasing disclosures set forth in S.1152, as well as alternative legislative approaches to simplification.

The Subcommittee expects to focus particular attention on the coverage of rental purchase agreements in S.1152. Consequently, comments concerning the adequacy of disclosure for consumers entering into rental purchase agreements, the necessity for coverage of rental purchase agreements under the Consumer Leasing Act, and the relationship between state and federal laws affecting these arrangements, would be most helpful.

A copy of the Committee's guidelines for witnesses is enclosed for your reference. The rules of the Banking Committee require that at least 75 copies of the testimony be submitted to the Committee's offices not later than 24 hours prior to the hearing.

If you require any additional information, please contact Linda Zemke of the Banking Committee staff at (202) 224-1564.

Sincerely,



Paula Hawkins
Chairman
Subcommittee on Consumer Affairs

Enclosure

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June 29, 1983

The Honorable Mark O. Hatfield
United States Senate
Washington, D.C. 20510

Dear Senator Hatfield:

Thank you for your letter of June 9 regarding the membership application of Great Western Bank, Dallas, Oregon, a proposed new bank. I am responding to your letter to Chairman Volcker since the application is now pending before the Board.

The application was initially filed with the Federal Reserve Bank of San Francisco in July 1981, but it was returned because of major informational deficiencies. The application was refiled in March 1982. During 1982, while the Reserve Bank was waiting for Applicant to identify an adequate management team for the new bank, Applicant's charter authorization by the Oregon Superintendent of Banking expired. Therefore, the Reserve Bank again returned the application to the Applicant. In 1983, the Superintendent of Banking renewed his authorization. A new application was filed with the Federal Reserve Bank, and the application was accepted for processing on March 31, 1983.

The Federal Reserve Bank of San Francisco has conducted a field examination in the Dallas, Oregon, area in connection with the application. The Reserve Bank has completed its final memorandum and has forwarded it, with its recommendation, to the Board for final review and action. Board staff will carefully review the findings of the Reserve Bank and will expeditiously bring the case to the Board for a final decision.

You may be assured that the application will receive careful consideration, and as soon as a decision on the case is reached, your office will be notified.

Sincerely,

(Signed) Donald J. Winn

Donald J. Winn
Assistant to the Board

JME:CO:pjt (#V-105)
bcc: Mr. Egertson
Mr. Ryan
Mrs. Mallardi ✓

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Federal Reserve Bank of St. Louis

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United States Senate

COMMITTEE ON APPROPRIATIONS
WASHINGTON, D.C. 20510

BOARD OF GOVERNORS
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FEDERAL RESERVE SYSTEM
1983 JUN 15 PM 12: 23
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RECEIVED

June 9, 1983

Mr. Paul A. Volcker, Chairman
Federal Reserve System
Constitution and 21st Street
Washington, D.C. 20551

Dear Mr. Volcker:

My leter today is on behalf of the Great Western Bank (In Organization) located in Dallas, Oregon.

Over two years ago, a group of progressive Polk County citizens concluded that there was a need for a new community oriented bank in the City of Dallas, Oregon. Their rationale was that since several chain banks were considering branching into Dallas when the home town bank protection act expires at the end of 1983, another bank was needed and would be successful in the community, but they felt that the area could best be served by a new local bank, owned and managed by local people to serve local people. An independent feasibility study by Dr. Jim Robb of Pacific Research, Inc. came to the same conclusions. The Oregon Superintendent of Banks, John B. Olin, confirmed their conclusions and authorized organization of Great Western Bank.

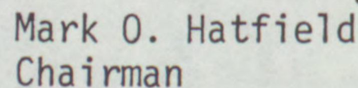
To date $1,250,000 in stock subscriptions has been collected from approximately 260 Oregonians who believe Great Western Bank will prosper and contribute to the economic growth of Dallas and Polk County. This money was raised last year, the bleakest period of the current economic cycle.

Membership in the Federal Reserve System is the final hurdle. The Federal Reserve Bank of San Francisco has had Great Western Bank's application since July 1981. It is my understanding that the Directors of Great Western Bank have requested that the Federal Reserve Bank of San Francisco forward their application to the Board of Governors for final consideration.

I am confident from the supporting information supplied with the application that there is adequate support for another successful bank in Dallas, Oregon and I urge timely and favorable review of Great Western Bank's application.

With best regards.

Sincerely,



Mark O. Hatfield
Chairman

MOH:aw

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Federal Reserve Bank of St. Louis

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

PAUL A. VOLCKER
CHAIRMAN

July 5, 1983

The Honorable Jake Garn
Chairman
Committee on Banking,
Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Garn:

The Board has reviewed the draft bill prepared by the Treasury Department to authorize new nonbanking powers for bank and thrift holding companies. The bill would provide for the use of a holding company as the vehicle for the conduct of nonbanking activities by banking organizations. It would extend the existing nonbanking powers of these companies to include services of a financial nature as well as those closely related to banking. In addition, the bill would authorize certain securities services, insurance and real estate brokerage, real estate development (with limitations on the amount of capital investment) and insurance underwriting.

I have, in numerous public statements, expressed the Board's support for appropriate expansion of nonbanking activities of banks to allow more effective responses to market incentives, provided that these activities and the manner in which they were supervised are consistent with the public policy objectives flowing from the unique role that banks play in our economy. Accordingly, we have been concerned that, as part of the process of powers expansion, account should be taken of prudential considerations and of the need to maintain the basic separation of banking from commercial and industrial activities. Fulfillment of these objectives, and the overriding need to maintain confidence in our banking system requires, we believe, a certain degree of supervision and regulatory oversight.

The provisions of the Treasury bill recognize these objectives and have the support of the Board. In particular, the terms and conditions for the authorization of expanded powers, and the provisions for follow-on supervision and examination, are sufficient to meet our concerns while not unduly limiting the ability of bank holding companies to compete.

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As to the powers themselves, while the Board will require additional time to consider fully whether or not any additional criteria for the insurance or real estate authorities might be appropriate, the Board is broadly in agreement with the additional powers contained in the Treasury bill.

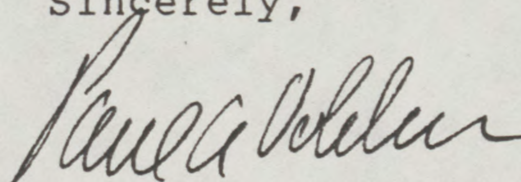
Similarly, with respect to S&L holding company powers, the Treasury proposal is an appropriate and reasonable starting point. At this time we have no specific suggestions to improve them. However, we will be giving this matter further consideration, particularly with respect to assuring competitive balance in powers and benefits among institutions offering similar services.

In addition, there are other matters not included in the Treasury proposal on which the Board may wish to suggest legislative action. These subjects include the need for rules to maintain an appropriate degree of coordination between authorities granted under State and Federal law, the possibility of changes in the laws establishing geographic limitations on banking activities, as well as the need to consider, as part of any comprehensive definition of the term bank, authorizing reserve requirements for companies that offer transaction accounts. The Board intends to expedite its consideration of these issues and make recommendations to you in the near future.

In the past, I have often stressed the urgent requirement for positive banking legislation to address the fundamental need to adapt the banking and financial system to a rapidly changing world. To allow the time for Congress to act on permanent legislation, I have previously submitted draft legislation to avoid a preemption of Congressional discretion in this area.

In our view, the Administration's proposal provides a complementary comprehensive approach looking toward effective competition in the provision of financial services while maintaining the nation's basic interest in the soundness and stability of the banking system. I hope the Congress could act quickly on this comprehensive legislation with a view to completing Congressional action by the end of this year.

Sincerely,



Identical ltrs. to Chrmn. St Germain, Cong. Wylie, Sen. Proxmire

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