Mr. Eccles
For your information
as requested
AGL

COPY February 20, 1934.

From Aubrey G. Lanston.

To Mr. Morgenthau.

The problems confronting the Federal Deposit Insurance Corporation, and those problems which the Postal Savings System may some day likewise have to face in a greater degree than at the present time, are similar to the problem confronting the Treasury in the handling of the investments and dispersements under the Adjusted Compensation Act.

Both the Federal Deposit Insurance and the Postal Savings are confronted with the problem of investing large amounts of funds and the possible necessity at some future date of selling large amounts of securities. The Postal Savings System has an alternative in that they may, instead of selling securities, call deposits from banks. Practical experience in handling collateral of Postal Savings Depositaries has given me a strong conviction that any sustained call by the Board of Trustees of their deposits in banks would necessitate a similarly steady offering of securities on a declining market. I do not share the belief of Mr. Eilenberger and Mr. North that the present level of deposits in the System will not meet a steady decline at some future period of greater confidence and higher business activity.

Attached hereto is a copy of a statement made January 2, 1925, by former Secretary of the Treasury Mellon regarding the Adjusted Service certificate Fund provided for in the Adjusted Compensation Act and the manner of handling the investments of that fund. Similar handling was eventually given to several other funds in subsequent years, the Civil Service Retirement and Disability Fund, the Foreign Service Retirement and Disability Fund, and the Canal Zone Retirement and Disability Fund.

I suggest that the method used in handling the Adjusted Service Certificate Fund and the other funds be followed for the purpose of investing the available balances of Federal Deposit Insurance Corporation and the Postal Savings System.

In order to simplify the current holdings of these funds and to provide a clear and simple picture for future handling (assuming it to be legally possible and mutually agreeable) that the current holdings of U. S. Government obligations be sold to the Treasury Department at the market and that the Treasury Department in turn sell to these two funds an equivalent amount of special Treasury certificates with such an interest rate as will meet the requirements of the two funds.

It is obviously impossible for the Federal Deposit to pay dividends as required by the Banking Act of 1933. The United States, through the Secretary of the Treasury, is the largest dividend-receiving stockholder of the Corporation. 4% Treasury certificates given to the Federal Deposit Corporation in an amount up to 90% of its available funds as of April 15, 1934, would permit the Corporation to cover its estimated annual expenses of $3,000,000 and pay a dividend of 5%. This is 1% below the apparent intest of the Banking Act of 1933. Receipt of dividends at 5% by the Treasury from the Federal Deposit would reduce the cost of the Treasury's interest rate to this fund to approximately 3.07%.

The Postal Savings System pays to its depositors 2% and receives from the banks 2½% so that an issuance of special certificates to the System of 2½% would very probably cover their needs. The rate on this certificate, however, could be better determined after further consultation and consideration by the Board of Trustees.

One of the purposes of the Act creating this System was purported to be the establishment of a place of safekeeping for funds desiring maximum safety which otherwise might be hoarded and the return of those funds through the functioning of the System to the territories from which the funds came in order that the credit needed for industry in the various localities would not suffer restriction. From a practical viewpoint, it is my opinion that the funds return largely to the financial centers and not to the communities from which they were obtained as a greater portion of the banks (my opinion only) use the deposits given them by the Board of Trustees to purchase the security which forms the collateral behind the deposits of the System. Cash funds received by the Treasury in payment of special certificates would more readily find dispersement generaly among the communities coming within the intent of the original Postal Savings Act through the current expenditures of the government under the recovery program.

The actual exchange of outstanding Treasury bonds held by the Federal Deposit and the Postal Savings for special certificates would not increase the funded debt of the government. Should it be legally possible to keep a certain small portion of these bonds alive in safekeeping, they could be sold to other trust funds, such as Indial Affairs who is administered by other than the Secretary, at prices in between the bid and asked of the market at such time as the particular fund would wish to make investments. The Government Life Insurance Fund, as an example, was forced to run the market up against itself in a small measure yesterday on an order to buy $1,500,000, long term, high coupon bonds. All of the order has not yet been completed although it was initially given February 14. Treasury Special Certificates might in the future be given this fund as well as the other two.

Cash funds obtained from the Federal Deposit and the Postal Savings would reduce by an equal amount those funds to be obtained in the open market from new issues.

Due to the extent that funds are withheld from investment for market reasons, there would seem to be some justification for Mr. Eilenberger's feeling that the Board of Trustees might be subject to criticism in view of the original purpose of the Postal Savings Act.

Should it be, in your opinion, more important to have the current moneys of the Federal Deposit and the Postal Savings available for support purchases rather than a reduction in the amount of new money to be borrowed, then through the issuance of special certificates the moneys obtained at least from the Federal Deposit Corporation could be used purely for that purpose without prejudicing the interest of the two accounts. To what extent moneys obtained from Postal Savings could be withheld for the same purpose would depend upon the weight given to the necessity of placing Postal Savings deposits immediately in circulation, as previously mentioned. Full consideration of the interest of the two accounts and of the market interests of the Treasury under the present system cannot be made to coincide.

The following might be considered as a policy matter by the Board of Trustees of the Postal Savings System. In October, they stopped giving out to banks new deposits, in view of the desire of the President that funds be made available for direct investment in the government market. In December, placing of deposits in banks was resumed, as the Treasury Department was unable to make investments fast enough to prevent the accumulation of large amounts of working capital on which the System was paying 2% interest to depositors and receiving no return. Temporarily, the Board might again cease giving out new or additional deposits to banks and purchase from the Treasury, as cash balances accumulated, additional special Treasury certificates. The principal objection to the building up of large cash balances by the System over and above the interest loss, was that the intent of the Act, as mentioned, was to get the money back into circulation. Expenditures of the government from the general fund to which the proceeds from the sales of these special certificates would be credited, as also previously mentioned, would probably place the funds more efficiently in circulation from the benefit of trade and industry throughout the country.