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PERSONAL AND CONFIDENTIAL

March 11, 1949.

Honorable Arthur H. Vandenberg,
United States Senate,
Washington, D. C.

Dear Senator:

I don't think it is "heresy" to ask a Federal Reserve Board member about an F.D.I.C. problem, but it might be "sheer heresy" to ask the F.D.I.C. about a Federal Reserve problem. In any case, I deeply appreciate your confidence. The subject of deposit insurance premiums is one to which we have given considerable thought because 85 per cent of the deposits in insured banks are held by banks which are members of the Federal Reserve System. I feel that the time has arrived when there should be a suspension of the assessments.

Like you, we have heretofore opposed a reduction of these premiums. We felt, during the period when deposit liabilities were rising and bank earnings were increasing substantially as a result of war financing, and the capital and surplus of the Corporation had not reached a billion dollars, that there was no basis for a reduction. Now, however, the picture has changed. The capital originally paid in by the Treasury and the Federal Reserve has been retired. The remaining surplus of the Corporation is well over the billion dollars specified by Congress and is increasing. Although the ratio of bank capital to deposit liabilities has decreased, the dollar amount of capital funds of banks has increased at least two-thirds since 1933, largely through the retention of undistributed net earnings. More than two-thirds of the deposit liabilities of the banking system are offset by cash, assets and Government securities which are the equivalent of cash. Even though this leaves a large dollar amount of what might be regarded as risk assets, the Corporation, in its latest Annual Report, for 1947, says that examinations show that less than one per cent of the assets of insured commercial banks were below the standards for bank investment. This, of course, does not mean that any substantial part of that amount would be a loss, nor would the losses all occur in one year.

I recognize that all banks are not in equally good condition. Probably there will be an increasing volume of losses. A slight down

turn in net earnings has already appeared. Some banks will require closer supervisory attention than others. However, the growth of risk assets and the estimation of prospective losses are reflected currently in the existing reporting and examination procedures of the supervisory authorities. This should enable the supervisory authorities to take precautionary steps in individual bank situations before losses accumulate to an extent sufficient to endanger depositors. In addition, the Federal Reserve is in much better position than ever before through its discounting, supervisory and credit control powers to protect the situation among member banks.

Since the reserves of the Corporation are nearing 1.1 billion, it is reasonable to expect an annual income of 25 million dollars or more from investments in Government securities alone, and since its current expenses are around 5-1/2 million, it seems likely that there would be at least 20 million dollars a year with which to meet current losses. This would be almost equal to the net loss of the Corporation during the fourteen years from its inception through 1947, the period covered by its latest Annual Report, which was only 26 million dollars.

In these circumstances, as I have said before, I would now favor the complete suspension of the assessments, with the understanding that the assessments would be restored, up to the annual rate heretofore authorized by Congress, whenever that might be necessary to maintain the reserves of the Corporation at an amount in excess of one billion dollars. The suspension of the assessments would add a substantial percentage to the net earnings of the insured banks. This in turn would increase the cushion between the Corporation and possible losses.

An alternative suggestion which was indicated editorially in the Washington Post this morning (a copy of which is enclosed) and which has a great deal of merit would be to deduct from the total amount of deposit liabilities of each insured bank the amount of cash assets and Government securities held by the bank and to apply the regular assessment rate against the balance, so that, in effect, the assessment would be against an amount equivalent to the risk assets. The reason for this suggestion lies in the obvious fact that cash assets and Governments would not be the source of loss, and that the insurance premiums, therefore, should be in direct relation to the other assets which might produce losses. If this suggestion were adopted, it would reduce the aggregate assessments by something like two-thirds. The proportion of the reduction would vary among the insured banks according to the amount of risk

Honorable Arthur H. Vandenberg

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assets which they hold and it would therefore be much more equitable than the present system.

If neither of the above two suggestions should be acceptable at this time, the limit on insured deposit liability, as a matter of equity, should either be removed entirely or it should at least be doubled, as \$10,000 at this time would be no more than \$5,000 was when the insurance system was established.

With warmest regards.

Sincerely,

M.S. Eccles.

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PERSONAL AND CONFIDENTIAL

March 17, 1949.

Dear Senator:

Referring to your letter of March 15, I am glad to have your impression regarding the problem of F.D.I.C. premium rates. I should like to suggest that you give some further consideration to the question whether a reduction would be advisable rather than a complete suspension. It seems to me that the important question to determine first is the adequacy of the surplus accumulated by the F. D. I. C. If it is adequate, there would seem to be no occasion for continuing the process of accumulation through assessments, especially when current net income is substantially in excess of losses. On the other hand, if the surplus is not adequate then there should be no reduction. If we assume that the surplus is sufficient, there will be great difficulty in determining the reason for continuing the assessment, even at a reduced rate. The reduction would have to be stated in the law or authority given to the F.D.I.C., in the law to make the reduction, and in either event some formula would have to be worked out. In the circumstances, any such formula would be debated and would be very likely to arouse an adverse reaction on the ground that the banks were being subjected to an unnecessary, as well as inequitable expense. I will not burden you with a discussion of the points that might be raised, but they would certainly include the fact that the risks were very unevenly distributed among the banks.

I cannot help but feel in the light of the available information that the surplus has reached an adequate amount, although I am aware of the arguments to the contrary. With a view to allowing something more, however, the effective date of the suspension of the assessment might be deferred until January 1, 1950, when, on the basis of current experience, it seems likely that the surplus will be around \$1,200,000,000. The F. D. I. C. could then be authorized to restore the assessment in whole or in part to such extent as might be necessary to maintain this amount, whenever new developments indicated that the surplus might decline to the amount on hand on January 1, 1950. It seems to me that this would be an approach to the matter which could easily be understood and should be acceptable to all concerned.

With warmest personal regards.

Sincerely yours,

The Honorable Arthur H. Vandenberg,
United States Senate,
Washington, D. C.

M. S. Eccles.

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