This report was handed to Chairman McCabe at a meeting which he held yesterday with the three members of the Sub-committee of the Federal Advisory Council, who submitted the report.

10/6/49

Mr. Eccles

CONFIDENTIAL

REPORT OF SUB-COMMITTEE OF THE FEDERAL ADVISORY COUNCIL ON F.D.I.C. ASSESSMENTS

This Sub-committee of the Advisory Council was appointed with power at the meeting of the Council on September 20, 1949 to give further consideration to Federal Deposit Insurance assessments in the light of the study prepared by the Staff of the Federal Reserve Board. After individual consideration of the problem, the Committee has met in Washington on October 4 and 5, and the following are its suggestions to the Federal Reserve Board.

The Committee wishes first to express its appreciation of the breadth and thoroughness of the study prepared by the Board's Staff. This is the most complete assembling of data and consideration of the questions at issue that the Committee has seen. In general, the Committee finds itself in concurrence with the broad approach to the problems and the line of reasoning of the Staff report, with reservations at some points.

The greatest difficulty may lie not in the broad objectives to be sought, but in securing agreement on a program. The American Bankers Association has a committee which has been at work on the subject for six years and has been carrying on conversations with the Federal Deposit Insurance Corporation as to modifications in the law. A number of other government agencies are concerned in the matter. From various sides many different suggestions have been made. It is our belief that the Federal Deposit Insurance Corporation is the agency which should present to the Congress a specific program based on its experience and studies. While the Federal Reserve System is broadly concerned in the matter, this is not primarily a Federal Reserve problem, and the Council at its two preceding meetings has given the Committee guidance in not wishing to sponsor a specific detailed plan. The Committee, therefore, in this report will rather emphasize certain principles which should be followed.

1. Reduction of assessment. The Committee can speak for the Council in its emphatic agreement with the Staff report as to the desirability of a prompt and substantial reduction in F.D.I.C. assessments. The Staff report reviews convincingly the loss experience both under the F.D.I.C. and previously. The capital of the banks in the country is now thirteen billion dollars. The F.D.I.C. at the end of this year will have one billion two hundred million of reserve funds and borrowing capacity at the Treasury of an additional three billion dollars. These are substantial sums in relation to fifty billion dollars of "risk assets" held by banks, on most of which we believe the risk is slight.

The point which the Committee would emphasize more vigorously than is done in the Staff report is the present need for larger bank earnings in order to accumulate bank capital more rapidly and to reopen the bank share market by giving the bank shareholder a fairer return. Bank shares are now selling at a heavy discount from their liquidating value, and most banks find it difficult to sell their shares in the market at fair prices to obtain new capital. Thus, from a long-range point of view of the strength of the American banking system and its capacity to finance expanding American business, the bank capital position needs to be improved over a period both by earnings and by the sale of securities in the market. A reduction in F.D.I.C. assessments will be a material aid toward this objective.

2. Nature of assessments. The Council has steadily taken the position that in any revision of F.D.I.C. assessments "provision should be made for maintaining the integrity of the fund" by the continuation of some

assessment, and the characteristics of this assessment should be (a) that fluctuations in the amounts should be statutory, with variations set by the law rather than by any board's current decision, (b) that the maximum assessment in any one year should not exceed 1/12 of 1%, and (c) that the annual assessment should be based on previous experience as to losses and expenses of the corporation, which together have recently been running under ten million dollars a year.

In the matter of the top assessment, the Staff report suggested 1/10 of 1% rather than the present 1/12. We believe that 1/12 is large enough, and it is accepted by the banking community and by the public as an appropriate maximum rate.

As to the length of past experience on which the changes in the assessment should be based, the Staff report makes the suggestion that a ten-year moving average is a sounder basis than a single previous year's experience. This avoids imposing a severe increase in the assessment at a time of depression. The Committee is impressed with the Staff proposal on this point, and believes this is one of the details on which the F.D.I.C. might be asked to make a definite recommendation. The question is partly one of the public reaction to reductions in the fund and the length of time that it would take to restore losses incurred. Our general feeling is that an average of a shorter period than ten years might be more acceptable from the public point of view.

3. Coverage. The Advisory Council at its May meeting stated its opposition to an increase in the coverage over $5,000. This Committee recognizes, however, the conclusion of the Staff that an increase in the coverage would not be inconsistent with or should not interfere with a

substantial reduction in the assessment. We also recognize that there is a certain amount of agitation for an increase in the coverage, particularly on the part of small banks. It is our belief, however, on the basis of surveys made by the American Bankers Association and other agencies, that this agitation is not substantial in scope, and we entertain doubt as to whether, in fact, smaller banks would be materially benefited in their deposits by an increase in the coverage. The matter should, however, be decided on broader public considerations. There does not appear to be from the public, as distinguished from the banks, any demand for an increase in coverage, and the present coverage does protect the small depositor, for whom it was primarily intended.

While we recognize that as it has been operated, deposit insurance has, in a great number of cases, protected entire banks through the purchase of assets, we are not convinced that situations may not arise in the future where the other method originally contemplated in the Act, of liquidating the bank and paying off from deposit insurance deposits of $5,000 and less, may not be a desirable method of procedure. If that proves to be the case, the limitation on the coverage will be conservative and desirable. We understand that the F.D.I.C. is making a survey of this problem, and suggest that final recommendations be deferred pending its completion.

It should be noted that the Federal Savings and Loan associations are now operating under an insurance program which also has a $5,000 limit, and that any change in the F.D.I.C. coverage may well be taken as a basis for a demand for an increase in the coverage in this other field, where the experience is still very limited and where a change now would involve substantial risks. Every extension of the principle of government guaranties needs to be examined with the utmost care before adoption.

4. Simplification of accounting basis for assessments. The Committee agrees completely with the Staff report as to the desirability of simplifying the basis for assessment and bringing it into harmony with the definitions in the Call Reports of the Comptroller and the Federal Reserve. The present uncertainties are disturbing, and a considerable savings in expenses could be effected by the proposed procedure.

5. Relationship of size of fund to deposit total. The Committee has given consideration to the suggestion of the Staff report that the fund be related to total bank deposits. It is the Committee's feeling that this is an unnecessary complication of the program. Legislation on this subject should be as simple as possible. The various proposed plans now under consideration for the continuation of assessments make provision for a continued increase in the fund year by year, in addition to the coverage of expenses and losses. This increase in the fund is in the neighborhood of 3%, which is about the same rate of growth as in the country's business. It seems to us, therefore, that there is adequate provision for growth without introducing an additional formula. If there were a formula,we would question basing it on total deposits.

6. Treatment of new members. The Staff report raises the question whether new members of the F.D.I.C. system should pay larger assessments for a few years. It is our belief that this is a question which could well be left to the F.D.I.C. for its recommendation. New members would necessarily have small resources, and the contribution to the fund would be in negligible amounts.

W. Randolph Burgess

Frederic A. Potts

Robert V. Fleming, Chairman

October 5, 1949.