BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date April 5, 1943

To Chairman Eccles

From Mr. Ransom

Subject: H.R. 1699 - War Loans Deposits Bill.

Attached is a copy of a copy of a letter and its attachment from Mr. G. C. Williams, President, State Bank and Trust Company, Evanston, Illinois, addressed to Mr. Steagall on the above bill. It was received in the Secretary's office at nine o'clock this morning. It has just reached my desk and, as it is to be put in circulation, I am sending you a copy because I think you should be familiar with its contents as some question on this may arise while you are on the stand tomorrow.

Attachments

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STATE BANK AND TRUST COMPANY
Member Federal Reserve System
Evanston, Illinois

April 2, 1943

Honorable Henry B. Steagall, Chairman
Banking and Currency Committee
House of Representatives
Washington, D. C.

Dear Sir:

I wonder if you feel that the "War Loan Account" bill which would eliminate cost of F.D.I.C. assessments on deposits in this account makes an equitable reduction in the amount paid by banks to the F.D.I.C.?

It would seem that this will depend on a proportionate distribution of War Loan funds to the banks. I assume the Treasury has full control of these deposits and can leave little or much or none in War Loan Accounts as it sees fit. I doubt if it would be practicable for the Treasury to distribute War Loan Account funds in such a manner as to provide an equitable reduction in the amount all banks would pay to the F.D.I.C. In any event, the funds are not so distributed at present. For example, the First National Bank of New York shows in its published statement United States Deposits of 300 million out of total deposits of 887 million. The smaller banks generally throughout the country have no such proportion of U. S. Deposits. If it is thought to be necessary and advisable to reduce the amount of payment to the F.D.I.C. by the member banks, it would seem that the fair way to do it would be to reduce the rate of assessment on deposits, which would make the reduction equitable. Nearly all of the bills that have been introduced in the past few years attempt to change the formula for arriving at the deposit base, such as elimination of interbank deposits, eliminating the amount of required reserves or the amount of War Loan Deposit, all of which vary proportionately in substantial amounts in different classes of banks, banks in different Reserve areas, and banks with different kinds of deposits. A straight reduction in payment by deducting the cost of one examination of national banks from the amount to be paid to the F.D.I.C. by that class of banks was proposed in the Ford Bill. Each of these proposals tampers with an existing equity.

It was a wise arrangement when total deposits were made the basis for F.D.I.C. assessments. It hardly seems possible to arrive at a more simple or equitable base. It would seem that the saving afforded in the present bill would be enjoyed in an inequitable amount by the banks with a large proportion of their deposits in War Loan Account. It would further seem that an investment in Treasury Bills with a floor under the yield of 3/8% provided by the Federal Reserve Banks will compensate banks for the 1/12% premium they pay to the F.D.I.C. on War Loan Deposits.

All of the money in the F.D.I.C. was contributed by the member banks including the Federal Reserve Banks -- not by the Government, the United States Treasury, or the taxpayers -- and the Corporation or its funds should not be used to reward or coerce any particular group or class of banks as such. If the amount of payment to the F.D.I.C. should at any time be increased or decreased, why not do it equitably, by raising or lowering the rate from the present 1/12th of 1% and not weaken the option of any group or class of banks to retain membership in the F.D.I.C. by indirectly shifting a heavier portion of the load on them.

Very truly yours,

(Signed) G. C. Williams

President

G. C. Williams
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Several bills have been introduced in the past few years to reduce the amount paid by banks to the F.D.I.C. Here are the methods that have been attempted. None effects an equitable reduction.

1. Eliminate interbank deposits from assessment.
   Interbank deposits range from none in a large number of banks to billions in a few. There is no equity here.

2. Deduct the amount of required reserves from the deposits subject to F.D.I.C. assessment.
   Reserve requirements have varied from 3% to 26% in the past few years, according to type of deposits and location of banks in defined reserve areas. There is no equity here.

3. Deduct cost of one national bank examination from premium paid to the F.D.I.C.
   The 48 States and local clearing house organizations require varying numbers of examinations per year at varying costs. There is no equity in making this contribution of F.D.I.C. funds to national banks.

4. Deduct the amount of War Loan Deposits from the deposit base.
   The amount of these deposits ranges from none to millions in various banks. It will be difficult or impossible to effect an equitable reduction by this method.

April 26, 1943.

Honorable Henry B. Steagall, Chairman,
Committee on Banking and Currency,
House of Representatives,
Washington, D. C.

Dear Mr. Steagall:

The Board of Governors of the Federal Reserve System respectfully recommends that the temporary authority contained in the second paragraph of section 16 of the Federal Reserve Act to use direct obligations of the United States as collateral security for Federal Reserve notes be extended for an additional period of two years expiring on June 30, 1945. For the consideration of your Committee there is enclosed a draft of a bill which would accomplish this purpose.

Section 16 of the Federal Reserve Act was amended by the Act of February 27, 1932, so as to provide that until March 3, 1933, the Board, if it deemed it in the public interest, should have authority, by the affirmative vote of not less than a majority of its members, to authorize the Federal Reserve Banks to offer and the Federal Reserve Agents to accept direct obligations of the United States as collateral security for Federal Reserve notes. This authority was extended for temporary periods by the Acts of February 3, 1933; March 6, 1934; March 1, 1937; June 30, 1939; and June 30, 1941. Unless renewed this authority will expire on June 30, 1943.

During the early years covered by these amendments direct obligations of the United States were pledged as collateral for Federal Reserve notes until the amount of gold certificates held by the Federal Reserve Banks and due from the United States Treasury increased to such an extent that it became unnecessary to continue the use of direct obligations of the United States as collateral. From May 28, 1938, until recently the amount of such gold certificates was so greatly in excess of the amount of Federal Reserve notes in circulation that the Federal Reserve Banks were able to pledge gold certificates with the Federal Reserve Agents as collateral security for all Federal Reserve notes issued to them, without in any way impairing their reserves against deposits. However, as the result of a steady increase of money in circulation during the past two years, it has become necessary for the Federal Reserve Banks to pledge Government securities with the Federal Reserve Agents as collateral for Federal Reserve notes. Furthermore, the demand for currency has been increasing at the rate of $400,000,000 a month. As of April 14, 1943, six of the Federal Reserve Banks had pledged government securities as collateral for Federal Reserve notes in an amount totaling $505,000,000.

The Federal Reserve System has undertaken to see to it that member banks have reserves which will be adequate at all times to enable them to carry their share of private and governmental financing due to the war program. Purchases of United States government securities by the Federal Reserve Banks in the open market or otherwise in order to carry out this undertaking result in additions to member bank deposits, and to their reserve accounts at Federal Reserve Banks against which the Federal Reserve Banks are required to hold 35% reserves. For Federal Reserve notes issued, the Reserve Banks are required to provide collateral, dollar for dollar, in the form of eligible paper of which the Federal Reserve Banks hold very little, or of gold or of United States government securities.

In these circumstances, if the authority to pledge government securities as collateral for Federal Reserve notes should be allowed to expire, the Federal Reserve Banks could not continue to meet the combined requirements of reserves against deposits and collateral for Federal Reserve notes due to the heavy credit requirements of war financing. Accordingly, it is urged that the authority to pledge government securities against Federal Reserve notes be extended.

Very truly yours,

M. S. Eccles,
Chairman.

Enclosure

May 11, 1943.

Honorable Henry B. Steagall, Chairman,
Committee on Banking and Currency,
House of Representatives,
Washington, D. C.

My dear Mr. Chairman:

During the course of my testimony before your Committee on May 10, 1943, with regard to the bill H. R. 2634, "to extend the period during which direct obligations of the United States may be used as collateral security for Federal Reserve notes", it was requested that I submit for the record a statement as to the maximum possible expansion of deposits and currency by the Federal Reserve System. I am pleased to enclose herewith a statement indicating the possibilities in this connection.

Very truly yours,

M. S. Eccles,
Chairman.

Enclosure.

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RESERVES OF LAWFUL MONEY AGAINST DEPOSITS OF FEDERAL RESERVE BANKS

Under the third paragraph of section 16 of the Federal Reserve Act (U. S. Code, Title 12, sec. 413) every Federal Reserve Bank is required to maintain reserves "in gold certificates or lawful money" of not less than 35 per cent against its deposits and reserves in gold certificates of not less than 40 per cent against its Federal Reserve notes in circulation.

The term "lawful money" is not defined by statute, but the decisions of the courts indicate that the term includes the classes of money which are declared by the laws of the United States to be legal tender.

Prior to 1933 Federal Reserve notes were not stated by the law to be legal tender and therefore were not considered "lawful money" for the purpose of the provisions of the Federal Reserve Act referred to above. However, by the Act of May 12, 1933 as amended by Public Resolution of June 5, 1933, all coins and currencies of the United States, including Federal Reserve notes, were made legal tender for all debts, public and private. Accordingly, all forms of currency of the United States, including Federal Reserve notes, may now be looked upon as lawful money.

Under the provisions of the Federal Reserve Act above mentioned, therefore, it would be theoretically possible to consider Federal Reserve notes, as well as other coins and currencies of the United States, as "lawful money" constituting a part of a Federal Reserve Bank's reserves against its deposits. Such a use of Federal Reserve notes, however, would be tantamount to an evasion of the general intent of the law, and, of course, as a matter of practical operation, Federal Reserve notes are not counted as a part of any Federal Reserve Bank's reserves.

GBV:lim
5/11/43