

A beer and root-beer distributor with a net worth of about \$18,000 requires \$5,000 for additional working capital during the summer months. This he is unable to obtain.

A manufacturer of neon signs complained of the high cost of the limited bank credit he receives.

A musical instrument company which is receiving some bank credit could, if \$10,000 of long-term capital were obtainable, expand its business.

A very small 5-and-10-cent store with no bank credit would like \$1,500 as a long-term loan to augment working capital and install modern fixtures.

A small manufacturer of ornamental wire products burdened with high accounts payable would like \$5,000 of long-term money to increase its working capital. It is unable to get bank credit.

A casket company with sales between \$40,000 and \$100,000 and with heavy accounts receivable was turned down by the banks and forced to curtail operations.

An electrical appliance and fixture business unable to obtain adequate bank credit claimed that with \$6,000 they could discount their bills and show profits.

A wholesaler of radios, refrigerators, and household appliances with sales of around \$180,000 is forced to go to finance companies for accommodation, as is a music store with sales of about a third that amount.

A Denver distributor of busses and trucks finds himself unable to get the local banks to finance his cash purchases from motor-car manufacturers when he has effected sales. He also discounts his paper with finance companies. He wants \$3,000 for 1 year.

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A timber company sells timber exclusively to coal mines, receiving much of its payment in coal. The delay between the cutting of timber in the summer and the sale of the timber the following winter (or the subsequent sale of coal received) ties up its working capital. It cannot obtain bank loans on the timber as security. The Reconstruction Finance Corporation refused aid. With \$5,000 it could extend operations, employing eight or nine men. It believes it could liquidate such a loan out of the profits of its increased operations.

A pipe and machinery concern with a net worth of around \$13,000 finds itself at a disadvantage as against its large competitors. The proprietor feels that \$10,000 would enable him to increase inventory, hire salesmen, advertise, and pay off about \$3,000 of present indebtedness.

A wholesaler of air-conditioning equipment and refrigerator parts in San Francisco shows sales of \$170,000. Inventory averages \$35,000. About 20 persons are employed. An application to the Federal Reserve bank in 1936 for \$10,000 to expand inventory was refused on the grounds that an insufficient business history could be shown. It is claimed that additional earnings of \$3,000 would result if discounts could be taken and that additional savings would be made possible through bulk purchases.

A wholesale hardware dealer with sales of \$80,000 and profits of \$3,000 needs additional working capital in order to take advantage of discounts. The banks declined the loan because of the lack of outside resources of the partners and the limited scope of the business.

A partnership of two men importing and wholesaling beverages went into the liquor business in 1934. With sales of over \$1,000,000 they tried in 1936 to get a loan of \$100,000 from the Federal Reserve bank to refinance a bank loan, to finance withdrawals of whisky, and to provide additional working capital. The loan was refused. One of the partners complains that their large competitors obtained bank credit on more favorable terms than are afforded them. As a result of their inability to obtain additional credit they have been forced to curtail operations.

In Portland, Oreg., a trailer manufacturer needs \$10,000 of long-term capital. He was offered this from private sources, but refused because it involved the loss of control of the business.

A mattress company could use a small loan for additional working capital. It is unable to obtain bank accommodations and is considering an application to the Reconstruction Finance Corporation.

A winery and distillery could have gotten \$25,000 last year from the Reconstruction Finance Corporation if a bank would take 50 percent of the loan. It was unable to find a bank willing to do this.

An insecticide company borrowed \$2,000 last year from the Reconstruction Finance Corporation which required that the loan be amortized \$100 a month. The company would like an additional \$1,000 and a longer term for repayment.

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A lumber company with a line of \$20,000 bank credit needs an additional \$20,000 to modernize its plant. It has hesitated to apply to the Reconstruction Finance Corporation because it does not want to mortgage its property and is afraid of being turned down.

A dry-ice manufacturer with earnings of \$11,286 last year wants \$80,000 to \$100,000 to expand capacity.

A dress manufacturer in Seattle wants \$5,000. A bank advanced \$5,200 which has been reduced to \$3,100. The bank now wants the balance repaid at once. The company showed a small loss last year although the business had previously been profitable.

A supply company supplying fishermen on long-term credit is using its full line of \$35,000 of bank accommodations. It could use \$25,000 of long-term capital to extend further credit to its customers.

A fireworks company which receives banking accommodations needs more working capital in order to operate at capacity. An application for a \$40,000 loan was turned down by the Reconstruction Finance Corporation. The company refused an offer made from an eastern competitor for fear of losing control.

Senator WAGNER. Gentlemen, we have another very important witness—Mr. Draper, a member of the Federal Reserve Board.

STATEMENT OF ERNEST G. DRAPER, MEMBER OF THE FEDERAL RESERVE BOARD OF GOVERNORS, WASHINGTON, D. C. 6/1/39

Mr. DRAPER. Mr. Chairman and gentlemen, if you have no objection, I have a very brief statement here that I would like to make.

Senator TOWNSEND. Have you discussed this bill with the Board?

Mr. DRAPER. Yes; we have discussed it.

Senator TOWNSEND. And your views represent the Board?

Mr. DRAPER. No; they do not.

Senator TOWNSEND. You come here as an individual?

Mr. DRAPER. Just as an individual, and not as a representative of the Board.

Senator TOWNSEND. I think we ought to have for this committee the conclusions of the Board as well as those of individuals.

Mr. DRAPER. I think the chairman of the Board will present the conclusions of some of the other members of the Board. Mr. Eccles intends to testify on Monday.

Senator WAGNER. You may proceed.

Mr. DRAPER. In testifying on this subject, I wish to make it clear that what I shall say represents only my own personal views and not necessarily the views of the Board of Governors of the Federal Reserve System.

This subject of loans to small business has been such a controversial one that there is danger either of (1) no satisfactory legislation being enacted or (2) such elaborate machinery being set up as to cause the Government an inordinate amount of expense in order to relieve a situation that might have been cured by simpler and more economical means.

Since June 1934 the Reconstruction Finance Corporation and the Federal Reserve banks have had authority to make loans to business and industry subject to certain limitations; and the authority of the Reconstruction Finance Corporation in this respect was broadened by the act of April 13, 1938. Under the present law, the authority of the Reconstruction Finance Corporation to make such loans will expire on June 30, 1941; but there is no such time limitation on the authority of the Federal Reserve banks to make loans to business and

industry. However, the Federal Reserve banks are authorized to make such loans only with maturities of not exceeding 5 years and only in order to provide "working capital" to businesses that are "established." It is obvious that these restrictions prevent the granting of credit in many legitimate cases where it might be helpful to small business and to the community at large.

Many persons with knowledge of the general problem genuinely feel that the existing avenues for credit to small industry are insufficient. They insist that there is a legitimate need for credit on the part of small but sound concerns and that this need is not at present being met by any agency, either public or private.

The results of certain surveys which have been made on this subject purport to show that there is no need for additional credit facilities for small businesses. I do not doubt that such surveys have been made in the utmost good faith; but the results are not convincing to me, because the conclusions are based very largely upon the fact that only a small percentage of persons to whom questionnaires were sent replied to them. There are many reasons other than the lack of need for additional facilities which may account for the failure of many businesses to reply to such questionnaires.

Why not get to the bottom of this problem, once and for all, by devising legislation which is simple in character, inexpensive in operation, and cooperative in its approach? In this way we could meet the present difficulty squarely and without reliance upon an entirely new set-up of elaborate and perhaps unwieldy machinery. Then, if it should develop after the passage of such simplified legislation that the need is not as great as anticipated, no great harm would be done and no great expense incurred. If, however, the need should prove to be greater than anticipated, the flexible machinery of this new plan could easily take care of any increase in demand, regardless of its volume.

There is much to be said in favor of the approach to this problem proposed in the Mead bill, since it avoids the creation of an additional system of banks, which would be expensive and slow to get into operation, and seeks instead to encourage the use of part of the enormous amount of credit now lying idle in the banks by providing insurance through the Reconstruction Finance Corporation, which is already in existence and has accumulated much experience in this field.

I believe, however, that the bill could well be improved and liberalized in some respects. I have here a memorandum containing suggestions for the improvement of certain technical features of the bill, which I shall ask leave to have inserted in the record at the conclusion of my testimony; but I wish at this point to mention one feature of the bill which I think especially needs liberalization.

Under the bill as now drafted—page 2, line 8—the Reconstruction Finance Corporation could insure a lender only against any loss in excess of 10 percent of the amount of the loan. In other words, the insured lender would have to absorb all loss up to 10 percent of the amount of the loan and the insurance would only cover any loss that might occur in excess of that amount. Insurance so limited might not afford sufficient protection to encourage banks to make loans on a more liberal basis than they would without insurance, and thus the bill might fail to accomplish its chief purpose. I believe that the policy of retaining a local interest in each loan could be preserved

and the beneficial effects of the legislation could be greatly increased if the bill were amended so that the insured bank and the Reconstruction Finance Corporation would share any loss that might occur on some pro rata basis to be specified in the law.

I also hope that your committee will consider the advisability of adding to this bill a separate title providing for the utilization of the existing machinery of the Federal Reserve System in extending additional credit facilities to small businesses on a much more liberal and flexible basis than the Federal Reserve banks are now permitted to extend under the limitations prescribed in section 13b of the Federal Reserve Act. Such a plan deserves careful consideration, because the existence of the 12 Federal Reserve banks and 24 branches located strategically throughout the United States, and already staffed with trained and experienced personnel, offers an excellent opportunity to decentralize the actual administration of this business and have it handled locally by persons familiar with the problems and already in close touch with the banks of the regions in which the applications arise.

At the same time the assets and liabilities resulting from such operations could be segregated in a separate corporation organized as an integral part of the Federal Reserve System, utilizing the existing personnel and other facilities of the Federal Reserve banks and acting under the general direction of the Board of Governors, which could be charged with the duty of seeing that the corporation functions in such a manner as to meet whatever legitimate need there is for additional credit facilities for small businesses, either directly or through cooperation with existing banks and other financing institutions.

I wish to make it clear that this is proposed as an addition to the Mead bill and not as a substitute for it. The provision of such additional facilities on a regional basis could not in any way impair the effectiveness of the facilities provided for in the Mead bill but would supplement those facilities in a manner which might prove to be very helpful.

With reference to suggestions for improvement of S. 2343, I submit the following:

The provisions in the bill regarding the distribution of losses—page 2, line 8—differ from those which are contained in other insurance plans set up by Congress. The bill, as now drafted, provides that the Reconstruction Finance Corporation may insure against the whole or any part of a loss which an insured bank may sustain in excess of 10 percent of the principal amount of the loan. Thus, for example, if a loss of \$10,000 were suffered on an insured loan of \$100,000, the insured bank would have to bear the entire loss and the Reconstruction Finance Corporation none. Since a bank would derive no benefit from the insurance until after it had suffered a loss equal to 10 percent of the loan, a question arises whether the bill in its present form would give sufficient encouragement to banks to make such loans on a more liberal basis than they would without such insurance. It is believed that the benefits afforded by the bill might be more generally utilized if this provision were changed so that the insured bank and the Reconstruction Finance Corporation would share in such loss as might occur on some pro rata basis to be specified in the law.

It is also believed that more loans would be made and increased benefits derived from the legislation if more flexibility were provided

in the bill with respect to rates of interest and the insurance premiums. The restrictions in the present draft in these respects may result in limiting the usefulness of the additional facilities provided by the bill.

The fifth limitation in section 3 (b) of the bill—page 3, line 22—would forbid the making of such loans to a borrower of which an officer, director, or security holder owning more than 10 percent of any class of the borrower's stock is, or has been within the preceding 12 months, a director of the bank making such loan. It is doubtful whether this restriction would serve any useful purpose and it may prevent the making of sound and desirable loans. It is believed, therefore, that the bill should be liberalized by eliminating this restriction.

The bill would be improved if the provisions of section 5 regarding the rediscount and purchase and sale by Federal Reserve banks of obligations evidencing loans insured under the bill were changed to a provision authorizing the Federal Reserve banks, subject to regulations prescribed by the Board of Governors of the Federal Reserve System, to make advances to member and nonmember banks for periods not exceeding 6 months at a time on their promissory notes secured by such obligations, at rates to be established from time to time by the Federal Reserve banks subject to the review and determination of the Board of Governors.

From the standpoint of practical operation, experience has shown that it is more convenient and less expensive both to the Federal Reserve banks and to the member banks for the Federal Reserve banks to make advances to member banks on their promissory notes secured by the pledge of assets than it is to rediscount such assets. Rediscounts, furthermore, are ordinarily held until maturity, so that the discounting bank has to pay the discount rate from the date of discount until maturity, whereas advances can be made for limited periods and renewed from time to time as the circumstances require, so that the borrowing bank pays interest only for the period during which it needs the credit.

If it is deemed advisable to provide a market in which such obligations can be sold, it is suggested that consideration be given to provision for the organization of a corporation to purchase such obligations and to issue and sell debentures against them, in a manner similar to that in which the RFC Mortgage Co. now operates in the field of insured mortgages.

It is not clear that the insurance provided in the bill would inure to the benefit of an institution which rediscounts or makes an advance against such a loan, since section 4 (b) provides that the insurance shall inure only to the benefit of any "assignee" or any "purchaser." To eliminate any doubt on this point, it is suggested that the remainder of the sentence following the words "the benefit of", on page 5, line 10, be changed to read "any person to whom such a loan shall have been assigned or pledged, or by whom such a loan shall have been purchased or rediscounted."

Senator HUGHES. Then your plan would take the place of the proposed bill, setting up credit by regional banks, would it not?

Mr. DRAPER. No, sir; it would not do that. It would be supplementary; but I am in an embarrassing situation, if I may say so, in that I would prefer not to discuss the plan except in very general terms, because I believe that the chairman intends to say something about it in detail.

Senator TOWNSEND. Are the amendments which you have suggested amendments worked out in the Board, or are they your individual thought?

Mr. DRAPER. No; they are amendments that were worked out partly as discussions in the Board and partly as discussions with members of the staff.

Senator TOWNSEND. Do you feel from your experience as a member of the Federal Reserve Board that there is a real demand for loans by little business?

Mr. DRAPER. Personally, I do feel that, Senator. When I was in the Department of Commerce as Assistant Secretary you may remember that we had quite a little discussion of this problem, and you may also remember that we had a meeting in which it was discussed at great length. Before that meeting we received about 4,500 letters, of which I should say 3,500 were not particularly revealing, but there were at least 1,000 or 1,200 letters which indicated to me that this problem was a real one.

Senator TOWNSEND. Why, under the provisions of the law which gave you \$139,000,000 to loan to business, have you not been able to loan it?

Mr. DRAPER. I pointed that out in the first part of my remarks, in which I said that the authority which was given to the Board of Governors was a somewhat restrictive authority; it prevented us from making loans beyond 5 years.

We could not make them except for working-capital purposes and only to businesses that were already established.

Senator TOWNSEND. Then you think that should be liberalized?

Mr. DRAPER. I think it should be liberalized; yes, sir.

Senator TOWNSEND. In what manner? Illustrate it specifically, please.

Mr. DRAPER. I think, in accordance, roughly, with the provisions of the Mead bill. They say, "for any purpose." They also say, I believe, that loans should run from 1 to 10 years.

Senator TOWNSEND. There is no limit in the R. F. C. They can loan for 10 years, or with no limit. If you had applications to your Board you could have suggested that they go to the R. F. C., could you not?

Mr. DRAPER. Yes. But I am not familiar with how the R. F. C. manages that type of business.

Senator ADAMS. Mr. Draper, this Mead bill will involve, will it not, essentially some changes in the deposit system of our banks? That is, our banks are required to make the major portion of their loans short-time loans?

Mr. DRAPER. That is true.

Senator ADAMS. This bill provides that the shortest period which could be guaranteed or insured would be 1 year.

Mr. DRAPER. That is true; yes, sir.

Senator ADAMS. Can you give an estimate as to the proportion of member bank loans which would at this time qualify for insurance?

Mr. DRAPER. I would not like to do that.

Senator ADAMS. Would you make a guess?

Mr. DRAPER. I would not, no; I prefer not to guess.

Senator ADAMS. It would be a very small part, would it not?

Mr. DRAPER. I would not like to say, because I am not sure.

Senator ADAMS. Your Board, of course, is given general supervision over the 12 Federal Reserve banks, and they, in turn, over the banks, and there are statutory limitations on loans, are there not?

Mr. DRAPER. That is true.

Senator ADAMS. And a loan beyond a year would be a loan secured by real estate, would it not?

Mr. DRAPER. That is true. Of course, under present regulations, I think a long-time amortized loan can be made by a bank today, but naturally the bank is very cautious about making that type of loan, and I think the bank is absolutely right in that attitude. I do not believe a bank should have an excessive amount of long-term paper. As I understand it, this legislation is to meet that particular need.

Senator ADAMS. But it would involve changing the type of loans which the banks are now making. It would involve also changing both the statutes and the regulations of the banking and currency departments of the States and the Federal Government?

Mr. DRAPER. I am not familiar enough with the legal aspect to be able to answer that intelligently.

Senator ADAMS. But the needs of small business in the way of long-time loans, capital loans, cannot be met in any substantial degree unless there was a change in the loaning authority to the banks, could they?

Mr. DRAPER. I think so, Senator. I think that a long-term amortized loan insured by the R. F. C. up to 90 percent would be a type of credit which the bank examiner, for instance, would not criticize.

Senator ADAMS. There is a limit as to the percent of the bank's assets that can be put into that type of loan, is there not?

Mr. DRAPER. I know of no limit, so far as the national banking system is concerned. There may be in various States.

Senator ADAMS. I am speaking of the national banking system.

Senator CLARK of Idaho. Ten percent of capital and surplus to any one person.

Mr. DRAPER. Even so; that would represent quite a large amount of loans.

Senator TOWNSEND. Depending upon the size of the bank, of course.

Senator ADAMS. Do you have any familiarity with the average interest rate received by your member banks, especially in the western part of the country?

Mr. DRAPER. I cannot answer that directly, Senator, but it was my feeling as I read this bill carefully that 4 percent is the average rate, and taking the whole country as a whole, that was a little conservative. I think there are sections of the country in which a bank would not be interested in making a loan of this type if it could only charge 4 percent.

Senator ADAMS. As a matter of fact, the smaller banks in the country, especially the western part of the country, could not survive on a 4-percent basis, with their small capital and their small deposits.

Mr. DRAPER. I can very easily believe that. However, I did notice in the bill that there was a provision which permits a sliding scale interest rate.

Senator ADAMS. I was asking the question because there was an implied criticism of that liberality from one of the leading members of the committee, if not the leading member.

Senator WAGNER. I do not know why you interpret that as a criticism. I asked to have it explained. But I did criticize the fact that there was no limit placed upon the amount of interest that may be charged under this bill. I was going to ask you, Mr. Draper, as to whether you had thought that in giving this power to permit the charging of a greater interest rate than 4 percent there ought to be some limitation.

Mr. DRAPER. Mr. Chairman, I look at most of these problems, of course, as a businessman, because I was only a businessman and not a banker; and with that in mind I think that matters of that type ought to be left to the administrative agency. The Reconstruction Finance Corporation is not going to make a charge which is unduly excessive, in my opinion. The more you tie their hands the more you restrict the beneficial effects of the bill.

Senator TOWNSEND. Is the Reconstruction Finance Corporation limited now as to interest?

Mr. DRAPER. I do not know, Senator.

Senator TOWNSEND. Are they not, as a matter of fact, making loans now as low as 3 percent?

Mr. DRAPER. I do not know that, Senator.

Senator TOWNSEND. Do you think the members of the Federal Reserve System are derelict in their duty in making longer term loans than they should make?

Mr. DRAPER. I do not; no, sir. But of course, as I stated, they are greatly restricted in the way in which they can make long term loans at the present time.

Senator TOWNSEND. Do you feel that the Federal Reserve banks have a large volume of applications which they have not approved, and which you think banks would readily approve and the R. F. C. would readily insure if this bill were enacted into law?

Mr. DRAPER. There was no use in a man making an application if he had to make it in accordance with 13 (b), because he knew in advance that he would not get the money. I personally think there are many applications that would be made if 13 (b) were liberalized; that is, 13 (b) of the Federal Reserve Act.

Senator TOWNSEND. What language would you use to liberalize it?

Mr. DRAPER. That is a matter, sir, about which I said I thought the chairman would give details in his testimony on Monday; and if you have no objection I would prefer not to go into that further.

Senator TOWNSEND. All right.

Senator WAGNER. Are there any further questions of Mr. Draper?

Senator CLARK of Idaho. I would like to ask one question, Mr. Draper. I do not know whether it comes within your hesitancy field; but how do you interpret "working capital"? Perhaps you would rather not answer that.

Mr. DRAPER. Working capital is capital which is used primarily for the day-to-day operation of the business and is not associated in any way with what you might call equity capital or long-term capital. In other words, if you make a loan to a man for working-capital purposes, the chances are that the length of that loan would be less than 1 year. But if you make a loan for capital purposes or equity-capital purposes, you may make it for any length of time.

Senator CLARK of Idaho. I was wondering if the only time restriction placed on you were a 5-year time limitation, how that would jibe with the working-capital loan, if by working capital you merely mean cash to meet pay rolls and perhaps buy supplies and things that go in and out the doors every day. That is my conception of working capital.

Mr. DRAPER. But, of course, working capital might be considered as capital that would be used in the business, let us say, for 1 or 2 years; certainly not in excess of 5 years. But if you consider working capital with respect to a loan made for a long term, and then expect the business to pay it back within 5 years, you are making a request that probably cannot be complied with by the average business.

Senator WAGNER. Thank you very much, Mr. Draper.

(The witness withdrew from the committee table.)

Senator WAGNER. I have received a letter from the Associated General Contractors of America, Inc., approving this proposed legislation, and with the request that it be placed in the record. It reads as follows [reading]:

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA, INC.

Washington, D. C., June 2, 1939.

HON. ROBERT F. WAGNER,

Chairman, Committee on Banking and Currency,

United States Senate, Washington, D. C.

DEAR SIR: The Associated General Contractors of America, Inc., with 2,300 members resident throughout the United States, wishes to record its approval of the purposes of S. 1482, a bill to provide for the insurance by the Reconstruction Finance Corporation of loans made by banks to business enterprises for the purpose of enabling such enterprises to increase their productions, extend their operations, and modernize their plants, and for other purposes.

As evidence of our particular concern and interest with respect to the sub-normal volume of commercial and industrial construction which has prevailed during the past few years, we submit that during the Seventy-fifth Congress, first session, this association sponsored legislation identified as H. R. 1987, which failed of enactment, but was designed to enable the Federal Housing Administration to insure mortgages issued in connection with the construction of commercial and industrial buildings, types of private construction that were lagging appreciably in their return to normal volume.

It is our belief that no better example can be submitted as to the value of Federal aid in restoring private building construction volume to normal than that afforded by the Federal Housing Administration insured mortgage and the consequent yearly increase in housing construction since its inception.

The insured-mortgage principle applied to commercial and industrial construction as contemplated under S. 1482, will, in our opinion, bring about a very material recovery of these types of construction and thus assist in relieving unemployment.

A study of the chart enclosed, entitled "Private Construction" will readily substantiate the effectiveness of the Federal Housing Administration in stimulating the volume of residential construction and will show the need of providing a similar form of Government aid in respect to commercial and industrial types of construction.

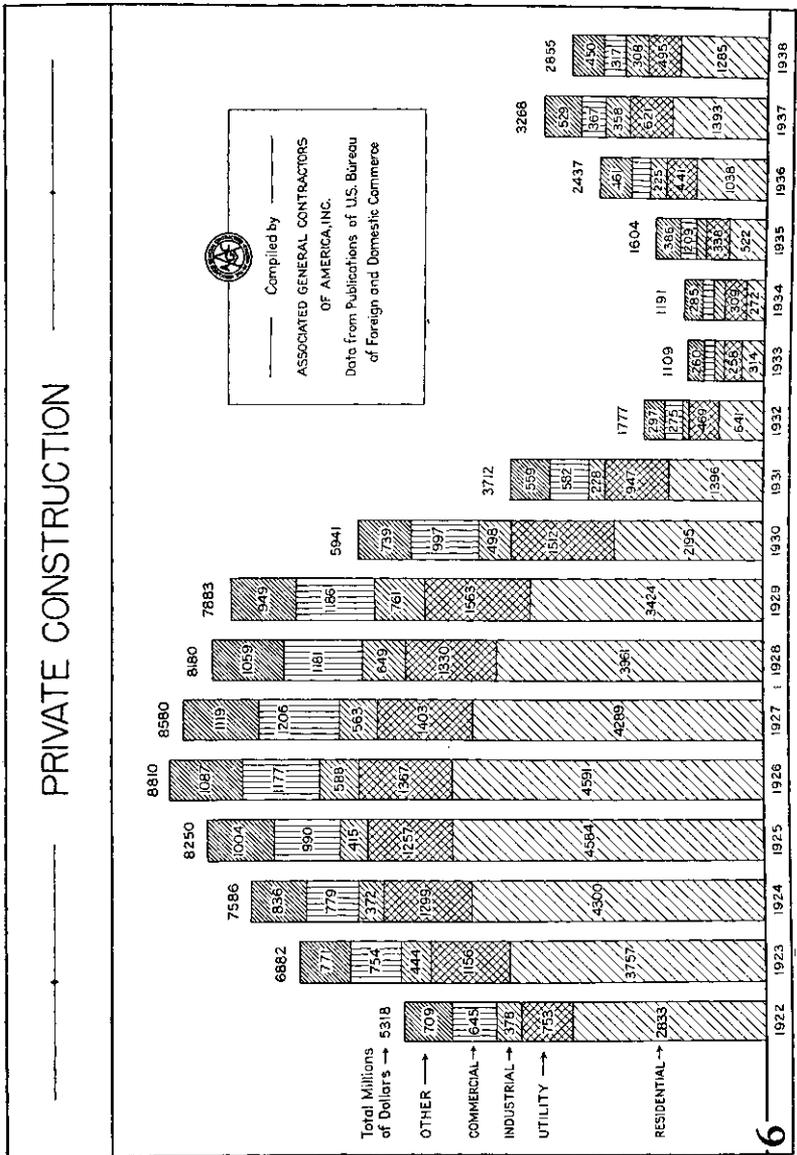
With respect to the provisions of S. 1482, it is our recommendation that the proposed limit of \$200,000 set for any one loan or advance of credit be increased to \$500,000. By doing this, it is our belief that benefits to private industry under the act will be more widespread.

Your favorable consideration of this most important and vital legislative proposal is solicited.

Very truly yours,

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA, INC.
By EDW. J. HARDING, *Managing Director.*

(The chart enclosed with the above-quoted letter is as follows:)



Senator WAGNER. We will adjourn now until 10:30 next Monday morning.
 (Whereupon, at 12:30 p. m., an adjournment was taken until Monday, June 5, 1939, at 10:30 a. m.)

TO PROVIDE FOR THE INSURANCE OF LOANS TO BUSINESS

TUESDAY, JUNE 13, 1939

UNITED STATES SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The subcommittee met at 10:30 a. m., pursuant to adjournment from June 5, 1939, in room 301 Senate Office Building, Senator Robert F. Wagner presiding.

Present: Senators Wagner (chairman of the subcommittee), Adams, Herring, Hughes, Clark of Idaho, and Frazier.

Senator WAGNER (chairman of the subcommittee). We will hear Mr. Edward Brown.

STATEMENT OF EDWARD E. BROWN, PRESIDENT, FIRST NATIONAL BANK, CHICAGO, ILL., MEMBER OF FEDERAL ADVISORY COUNCIL, MEMBER OF THE ADVISORY COMMITTEE OF RECONSTRUCTION FINANCE CORPORATION IN CHICAGO

Mr. Brown, you are a member of the Federal Advisory Council, and president of the First National Bank of Chicago, Ill.?

Mr. BROWN. I am; and I am also a member of the Advisory Council of the Reconstruction Finance Corporation in Chicago, and have been for a number of years.

Senator WAGNER. We have invited you here to discuss with us Senate bill 2343 and Senate bill 1482, and we would be delighted to get your views upon those pieces of legislation. First, are you speaking just for yourself, or do you represent any particular group or association?

Mr. BROWN. I am speaking for the Federal Advisory Council, at their request, Mr. Chairman.

The Federal Advisory Council at its meeting on June 6 passed a resolution directed to the Board of Governors of the Federal Reserve System, which I am informed was transmitted to the chairman of this committee on June 7. With the permission of the committee I would like to read it [reading]:

The Federal Advisory Council desires to call to the attention of the Board of Governors of the Federal Reserve System Senate bill No. 2343 on which hearings are now being held by a subcommittee of the Banking and Currency Committee of the Senate.

The Council believes that the great majority of businesses needing loans for a period of years, where a reasonable assurance of repayment exists, can and do obtain such loans from banks and other nongovernmental sources such as insurance companies. In those cases where such loans are not obtainable

from banks or private sources the Reconstruction Finance Corporation is already empowered by existing legislation to make, and through participation arrangements, in effect, to guarantee or insure percentages of such loans, and does so make and in effect insure loans.

Under present legislation the Reconstruction Finance Corporation is restricted in that the loans must be in the opinion of its board "of such sound value or so secured as reasonably to assure retirement or repayment" and to concern "only when in the opinion of the board of directors, the business enterprise is solvent." Under Senate bill No. 2343 no such restrictions are imposed. If it is the intent of the bill that the Reconstruction Finance Corporation will under it only insure loans the repayment of which in its opinion are reasonably assured, the bill should be so amended.

If it is the intent of the bill that the Reconstruction Finance Corporation shall insure loans the repayment of which in its opinion are not reasonably assured, and the Reconstruction Finance Corporation should insure such loans, the council feels that the result would be injurious to industry as a whole and would tend to restrict longer term credit now being made available by banks and others to businesses which in the opinion of the lenders do have reasonable assurances of being able to repay such credit. The extension of credit, through insurance or direct loans, by governmental agencies or by private capital, to businesses not able to repay not only is costly to the lender and does not benefit the borrower, but enables inefficient, poorly managed, and uneconomic businesses to compete for a time with other people's money against successful, well-managed, and economic businesses in the same line. By so doing it retards the expansion of sound business enterprises and because these are faced with unsound competition, makes it more difficult for them to obtain credit either short or long term, and makes it even more difficult for them to obtain additional proprietary capital. In fairness to the sound and solvent businesses of the country, and apart from any considerations of probable loss to the Treasury, the council believes that no governmental agency should be empowered to make or insure loans to industry or commerce unless after examination the agency feels that such loans are reasonably certain to be repaid.

The provisions for the rediscount of the insured portions of loans contained in the bill should be eliminated. In the case of member banks the Federal Reserve banks could under existing law accept them as collateral for short-term loans which can be renewed if necessary. Member banks should not be indebted through rediscounts to Federal Reserve banks over long periods of time as would be the case if notes running up to 10 years were rediscounted. Nor should nonmember banks be able to use the credit facilities of the Federal Reserve banks but should depend on their correspondents.

The Council urges that before legislation is enacted which puts the Government in the business of insuring industrial and commercial loans on a permanent basis, as contemplated by the bill, and which might have far-reaching ultimate effects on industry, commerce, and banking, that an investigation be made by Congress of the extent to which existing agencies meet the need for term loans on the part of business and of the extent of the unsatisfied justifiable demand for such loans. The Council is informed that various studies are in progress which might well be used in connection with such an investigation.

The Council requests that a copy of this expression of its views be sent by the Board to the subcommittee considering Senate bill 2343. If the subcommittee will give opportunity the Council would be glad to have one or more of its members appear and testify regarding the bill.

It is on the basis of that resolution or recommendation, Mr. Chairman, that I am appearing before the committee.

Senator ADAMS. For the sake of our record, Mr. Brown, will you explain how the Advisory Council is constituted?

Mr. BROWN. The Advisory Council was provided for in the original Federal Reserve Act. It consists of one representative from each of the 12 Federal Reserve districts, elected by the Board of the Federal Reserve bank in each district. It is required by the Federal Reserve Act to meet with the Federal Reserve Board at various times a year and to discuss the problems of interest to the Federal Reserve System with the Federal Reserve Board.

Is that a sufficient explanation, Senator Adams?

Senator ADAMS. Yes.

Senator WAGNER. You meet here in Washington, as I recall it?

Mr. BROWN. We always meet four times a year, and whenever there is any emergency we have special meetings in addition to the four regular meetings.

Senator ADAMS. As I get the point you are making, a loan which is not a sound loan is of course detrimental to the lender. That follows inevitably, and it is of no service to the borrower; and then, beyond that, the borrower, in failing conditions, normally will make excessive efforts to keep afloat, with the result that he becomes an unfair competitor of sound business; so that if you make an unsound loan to an unsound borrower you jeopardize a sound business interest?

Mr. BROWN. That is a point in the resolution; and I would be glad to testify as to one or two examples of such loans and their effect on competitive businesses later on.

Senator WAGNER. You may do so now if you wish.

Mr. BROWN. I would like to take up these points in order, if I may, Senator Wagner.

Senator WAGNER. Very well.

Mr. BROWN. There have been a number of expressions of opinion, not supported by data, given to this committee to the effect that there is a large or a very considerable unsatisfied demand for credit extending over a year on the part of businesses and businesses which might need to borrow up to sums as large as a million dollars a year, apparently.

It is the view of the council, all of whom are active bankers from all over the United States, that such is not the case. I can only testify from my own knowledge, because, obviously, neither I nor the Federal Advisory Council as a whole have been in a position to make a study of that situation affecting the whole of the United States. But I do know what is going on in the part of the country of which Chicago is the center. I do know, both as president of the First National Bank and as a member of the advisory committee of the Reconstruction Finance Corporation, the Chicago agency, as to the demand for credit which exists.

Right here I want to make a sharp differentiation between credit—that is, loaning money where such a reasonable assurance of repayment exists as to justify the borrower getting it at legal rates of interest, which banks are authorized to charge under the existing laws—and proprietary or risk capital, which nobody would be justified in furnishing at any legal rate of interest, and which is entitled by some arrangement in consideration of the risk it takes to a share in the profits, if profits are realized.

In my opinion, it has always been difficult for small businesses to get risk capital. I think the difficulties today, for a variety of causes, are greater in getting proprietary risk capital for small- and moderate-size businesses, and even for large businesses, than was the case in former years. In this bill the problem is approached not from the standpoint of the proprietary capital needed for business, but the loan capital which should be furnished at legal rates of interest and which inevitably carries with it the connotation that there is such a

reasonable certainty of repayment as to justify the borrower getting it at legal rates of interest.

In the Seventh Federal Reserve District a study was made under the direction of the Treasury Department by Dr. Jacob Viner and Mr. Hardy, of the Brookings Institution, of the extent to which the credit needs of business were not being met by the banks. It was a rather complete and exhaustive study, made by obtaining a large number of graduate students of various Middle Western universities, having them talk with some thousands of borrowers who complained that they could not get credit, and then going around and interviewing banks or loan agencies who declined their request for credit, to decide if the requests were justified. That is the last study that I know of; and it has been 5 years ago since there has really been made a thorough study of the subject.

The conclusions of the study showed that of the people who were declined credit only about 20 percent at that time could give any reasonable assurance of repayment. The report recommended at that time—and I might say that all of its recommendations have since been carried out—that banks be encouraged to adopt a more liberal attitude toward longer-term loans and loans which were not cleaned up in short periods; that bank examiners be instructed to take a more liberal attitude toward such loans, if they were sound; that the slow classification in bank examinations be abolished, and that the slow loan be not criticized if its repayment was reasonably assured; that the Federal Reserve Act be amended, as was done in 1935, to provide that such loans could be the basis of credit in time of need through the Federal Reserve Banks on the part of member banks; that the tests of the Reconstruction Finance Corporation as to loans that should be made should be liberalized, which was done by the amendment of 1938, and that their application forms should be simplified.

As I say, since the Viner report was made, covering the Seventh Federal Reserve District, all these various recommendations have been put into effect; and my observation is that virtually no small business or medium-sized business which is entitled to credit either for a short or a long time, and which can give reasonable assurances of repayment, fails to get it.

SENATOR FRAZIER. Are there quite a considerable number of smaller or average-sized businesses that would like to have loans, that are not considered safe risks, and cannot get loans from a bank for that reason?

MR. BROWN. There are a great many people who want loans, Senator Frazier, for all sorts and kinds of purposes, where the assurance of repayment is so doubtful that no prudent man will make the loans.

SENATOR FRAZIER. Do those requests come from what may be termed substantial business men?

MR. BROWN. Not to any very great extent; but there are some very substantial businessmen; substantial businessmen in the sense that they may have quite sizable businesses which, in times past, have been profitable, but which for a number of years have been steadily losing money because of conditions in the industry, or location, or poor man-

agement, and where there is grave doubt as to the ability to repay the loans. There are many such men who do want loans.

Senator ADAMS. Is it not the present situation that there is more of a demand for borrowers than there is for loans on the part of borrowers? That is, that the banks are looking for opportunities to make loans?

Mr. BROWN. The banks are all looking for opportunities to make all kinds of loans. Since the report of Dr. Viner in 1934 there has been a development in the last 5 years in that the banks of this country have gone very extensively into what is called term loans; that is, loans payable over a term of years, generally from 1 to 10; sometimes serial loans, and sometimes running for 5 years or 3 years, without prepayment. It is a development which has been encouraged by the difficulty of the banks in getting normal commercial loans, by the fact that such loans are now available as collateral in time of need at the Federal Reserve banks, and due also to the fact that many borrowers prefer them rather than going through the expense and delay of S. E. C. proceedings.

In the case of our own bank in the last 5 years we have made almost \$200,000,000 of such loans, and we have outstanding today some \$84,000,000 of them. They have been made in sums ranging from \$30,000 up to amounts of several million dollars. The majority of them are loans of several hundred thousand dollars.

Ordinarily the small business—not the business that is justified in getting a loan of \$300,000 or \$500,000 or \$700,000, but a business which wants to borrow less than \$100,000—cannot give the assurance of repayment over a long term of years that a large business can. It is due to a variety of causes. In the first place, the small business generally cannot afford more than one executive. If anything happens to that executive, the business is just out of luck. You can insure against his death, of course, but you cannot insure against his illness. The possession of smaller resources tends to make it much more difficult to predict whether in 2 years or 3 years or 5 years or 10 years that business will still be alive and going than is the case with a large business.

Senator FRAZIER. What is to become of these little-business men that need money and cannot get it because you consider them unsafe risks? Are they to get out of business or go broke?

Mr. BROWN. No, Senator. They do get loans. They do not get them in the form of long-term loans payable over a period of years, of the type that are envisaged in this pending bill. I have some statistics from our own bank here which I had made up. The bank may make a loan for a period of 6 months. Such a loan may be secured by assigned accounts, may be secured by the plant or inventory, or it may be entirely unsecured. It may be secured by real estate or some other collateral. If at the end of 6 months the business is still going, still is solvent, and is as able to repay as it was when the loan was originally made, the loan is renewed and re-renewed, and it goes on from year to year.

I have a tabulation in the case of our own bank of loans that have not been cleaned up, that were made originally for periods of under 6 months to businesses with net worths of under \$100,000, which we

will take, for the purpose of discussion, as small businesses, and which are totally unsecured, but because of the satisfactory condition of the business there has been no clean-up required. There are 22 such loans in our bank, aggregating \$798,000, dating back to 1934 and prior.

Senator FRAZIER. What is the rate of interest on loans of that kind?

Mr. BROWN. About 4 or 5 percent. We have a total of unsecured loans for working-capital purposes to small businesses of \$2,500,000. These are loans to businesses of a net worth of under \$100,000. We have loans to businesses with a net worth under \$100,000, secured by collateral other than real estate of some \$12,000,000. There are various types of seasonal loans; and when you go to businesses with a net worth of from \$100,000 to \$500,000, you find that where the business continues solvent, continues to give reasonable assurances of repayment, our bank and, it is my observation, other banks in Chicago and in the Middle West, do not insist on complete clean-ups as long as they are satisfied that the business can ultimately repay, but we keep renewing from time to time these loans to smaller businesses.

From the mental point of view of the small-business man, Senator, that is not as satisfactory as if he got a straight loan for 10 years; but owing to the greater hazards of smaller businesses, if you want to have a reasonable assurance of repayment, it is necessary originally to make the loans for short times, so that you can take frequent looks to see if the business is going well, and if it is not, to take steps to collect the loan.

Senator FRAZIER. Is it your opinion, then, that Congress would not be justified in passing a bill such as this S. 2343 for the purpose of making long-time loans to these smaller-business men?

Mr. BROWN. It is my opinion. It is my opinion, based on my experience, that no such need exists. Contrary opinions have been expressed here without supporting data. My opinion is shared by the 11 other members of the Federal Advisory Council. I think, under such circumstances, that before legislation of this type is passed, a statistical study of the extent of the unsatisfied demand for justifiable loans should be made by some independent agency, or by the committee itself, employing somebody like Mr. Viner, or using some similar procedure to his, to determine what the extent of this need is, and if it really exists in any such amount as to justify either a new type of loan agency or a new type of loaning by an existing agency—

Senator WAGNER. Mr. Brown, let us assume for a moment that there is a need for additional facilities for the small-business man that he is not able to secure. Would you then feel that this legislation meets that need? I mean, this particular kind of legislation which is pending. You say that there should be an inquiry as to whether there is really a need. But let us assume for the moment that there is a need. I am not asking you to concede it, but just to assume it.

Mr. BROWN. That there is a need by businesses which can give reasonable assurance of repayment?

Senator WAGNER. Of course, I assume that must be so as to every loan, that we could not expect a bank to make a loan without such assurance. But assuming that there is that need, would you say that

this particular legislation would be workable in providing the necessary credit?

Mr. BROWN. I do not think it would. I think the powers given the R. F. C. at the present time to insure loans are far greater than the powers given by this bill.

Senator WAGNER. You mean, by participation?

Mr. BROWN. By participation. The R. F. C. at the present time, whenever it is convinced that a sound loan exists, will go into a participation arrangement with the bank under which the bank takes 10 or 20 percent of the loan and it stands only its pro rata share of the loss. Under this bill, as Mr. Eccles pointed out in his testimony, the bank would have to assume the entire first 10 percent of the loss; and assuming the need, the present arrangements which the R. F. C. is constantly making with banks are much more likely to cause the banks to make such loans and get R. F. C. participation than this bill would.

Senator CLARK of Idaho. Do you have many of those loans now?

Mr. BROWN. We have a few; not many. As I tried to say, Senator Clark, we have tried very hard to make loans; and where we were satisfied that a long-term loan exists where payment is reasonably certain, we have made it ourselves; and we have made loans on terms of over a year to the extent of some \$200,000,000, and we have over \$80,000,000 of them today outstanding.

Senator WAGNER. What percentage of your applications for loans made by what we call the small-business men do you reject?

Mr. BROWN. I cannot give you that figure.

Senator WAGNER. Can you approximate it?

Mr. BROWN. No; I cannot, except to say that the percentage would certainly be less than 3 or 4 percent.

Senator WAGNER. Only 3 percent are rejected, you say?

Mr. BROWN. I would say less than that. I cannot give you the figures; but the average small-business man who comes in and wants a loan does not ask a large bank like ours for it unless he thinks himself that he is reasonably certain of repaying it.

Senator WAGNER. In your statement you spoke about loans which you made without security, I think. Did you not say that?

Mr. BROWN. Yes. You mean, short-term loans?

Senator WAGNER. Yes; short-term loans, without security. Are those what you call character loans? What induces such loans without security?

Mr. BROWN. They are character loans in a sense, yes; in the sense that we believe by experience with the borrower that he is honest, that he has ability in his business, that the business, from our experience with it, has been making money, and our belief that with the present management it will continue to make money. When one speaks of character loans, they are character loans in that sense. The term "character loans" as generally used in banking jargon are loans of under \$500 to somebody who has got no business and no assets, but only on the general belief that he will repay it—such loans are made by personal loan companies, and many banks are going into the making of them. They adopt various devices on that kind of loan to get higher than the 6- or 7-percent rates of interest, because the percentage of loss is great. That is, it is considerable; but the expense of collecting them and going around and dunning the man to pay

it is very great, and you simply cannot make that type of loan and live on a 6-percent interest rate in any great volume. When people speak of character loans, in the technical jargon of bankers, that is the type of loan to which they refer. If you mean by character loans that we will not loan to a man except one who has integrity and ability to make money, and we have confidence in him, all loans are character loans in that sense.

Senator WAGNER. Except that as to some you are protected by collateral, so that character does not enter into it to the same extent.

Mr. BROWN. There may be an exceptional case where we would loan on Government bonds or marketable stocks; but where you loan to a going business, you very rarely get collateral, and in the case of commercial loans we generally do not take collateral even in the case of these long-term loans, Senator.

Senator WAGNER. What is that money that you loan as a rule used for? Is it for working capital, capital investment, or what is the nature of the aid as a rule?

Mr. BROWN. The same loan may be used for several different purposes. In many cases it is used for what would be working capital, to enable them to carry more inventory and more accounts. In many other cases it is borrowed for the purpose of plant extension or for the acquisition of additional sources of supply, as in the case of a coal-mining company or a lumber company. It is very frequently, and I should say in the last few years it has been used, more than for any other purpose, to refund existing indebtedness at lower rates of interest. What the money is used for is to replace outstanding indebtedness at lower rates of interest.

We are interested in our estimate of a man's ability to repay and the soundness of his business. We are only incidentally interested in the purpose for which he uses it. We have made money on these loans, and do make them for capital expansion and for working capital.

In the case of these smaller loans which are made for 6 months, but which have been outstanding and renewed from time to time, we do clean up. I have some figures here as to the purposes, so far as we could determine, for which they were used; and in those cases the loans would come down and go up for what might be called seasonal working capital to the extent of \$3,000,000, roughly. These are businesses under \$100,000 of net worth; to the extent of \$15,000,000 for what you might call permanent working capital; to the extent of about two and a half millions for fixed capital. That gives you the bulk of them. In this tabulation that type of loan is for what you might call more or less permanent working capital.

If I may give you an illustration: We have a small business which supplies most of the horseradish to the retail grocers in Chicago. It is a one-man business. The product has a good reputation. It has never been advertised, but it is used all over Chicago. The business is more or less constant, because horseradish keeps and it is ground up into a sauce and put into bottles and there is a demand for it. That man has a fairly constant amount of inventory on hand and a fairly steady amount of good accounts receivable. He has probably a net worth of about \$50,000 or \$60,000, and makes \$15,000 a year, perhaps, out of his business, which in-

cludes his own time and salary. To my knowledge he has been indebted to us steadily for a good many years, and we have not been worried about it, because we loan him only for 6-month periods, and as long as he is managing the business it insures repayment. But we would not want to make that loan for a period of 1 to 10 years, because he might die tomorrow, or the public might decide that using horseradish is an unhealthy habit, or stop eating it for some other reason beyond our control.

Senator WAGNER. Are there any other questions?

Senator DANAHY. I would like to ask, if I can fairly restore to your mind, Mr. Brown, your line of thought at the time you said that it has always been difficult to get risk capital, but it is more so particularly of late, and, I quote, "for a variety of factors." Would you just indicate any of those factors? Or is that a fair question to you?

Mr. BROWN. It covers a great variety of ground. I should say, first, and most important of all, is that the people who have in the past put proprietary capital, expecting to get a share of the profits, into small businesses think that under present business conditions and the present political world conditions that exist, there is less chance of a business making a profit than there was 10 or 12 years ago. I think that is the estimate of the would-be investor in proprietary-risk capital in small businesses. He has that attitude. He thinks the chances of profit are less than in the 1920's or in the decade before the 1920's. I think that is the reason why it is difficult to get that capital.

I think a second reason, much less important than that, is that if he puts his capital into a small business, as risk capital, he feels that, if he makes money on the investment, the Government will take a very large percentage of it, and that, if he loses money, he will not get a proportionate deduction in his tax payments.

The third thing—but I do not believe that this applies except to businesses which want to raise several hundred thousand dollars of capital—is the expense of the S. E. C. registration and regulations. In my years of business experience, when a business was growing a man did not get his additional capital by going to the open market or by borrowing at simple interest. He put his own savings back in the business that was making money. If it looked like a good chance, he would go to people and get them to put \$10,000 or \$5,000 or \$25,000 into the business, and they might take stock in it; they might put it in in the shape of a loan with an option on the stock or make the proprietor of the business give up some of the existing capital stock as a bonus for making the loan. That type of investor expected to lose in a majority of his investments. He expected one out of three or four or five to make so much money that it would more than offset the loss on the others. It was only after the business got to a point where he had a net worth of \$400,000 or \$500,000, at least, that it began to go to the open market and get some stock house or some bond house to put out an issue of stock or convertible debentures, or debentures with warrants entitling them to buy stock which gave the prospective investor a chance to share in the profits if the enterprise was successful.

Senator DANAIER. Thank you.

Senator CLARK of Idaho. Do you think that equity or long-term financing could be done today in amounts, say, from \$100,000 to \$500,000 by small bond houses, provided the limit was raised, say, to \$500,000 for S. E. C. registration; would the cost be too prohibitive even if the limit were raised to \$500,000?

Mr. BROWN. I do not know about a limit of \$500,000. I think some could be done, but I think a very considerable amount could be done between \$500,000 and \$1,000,000. I might say in that connection that the First National Bank of Chicago, before 1933, had an affiliate, the First Trust & Savings Bank, which in 1933 was merged into the First National Bank. It was an incorporated State bank with a savings department and trust business, and it was probably the largest distributor of industrial bond issues in the city of Chicago, both large and small; and every year we would put out a number of small industrial bond issues. When I say "small" I mean ranging from \$500,000 to a million and a half. The various investment banking houses which are still alive and doing business in Chicago put out similar issues. These would frequently have conversion privileges of stock warrants or something to give the buyer a chance for more than simple interest if the enterprise was successful.

Answering your question categorically, I think that if the limit of exemption under the S. E. C. were raised a certain amount of bond issues and stock issues in the amount of several hundred thousand dollars could and would be floated that are not now floated.

Senator ADAMS. Mr. Brown, you made a suggestion a while back as to the number of risk investments that an investor might think he would have to make in order to find one profitable one. In your experience what estimate have you arrived at as to the percent of risk investments which proved to be unfortunate; or, to put it the other way, what percent was profitable?

Mr. BROWN. That is awfully hard to say, Senator. I was not a rich man, but before the late depression I put sums ranging from \$5,000 to \$25,000 into quite a number of enterprises. Taking the grand result, I made money on them; but four out of five failed. The fifth would make enough money to make up for the losses in the others. But what the experience of other people has been I do not know. I have had some of my friends who probably made a hundred investments in mining and oil companies and have not had a single one of them give them any return. On the other hand, there are some people who take a lesser degree of chance, and probably have gotten returns in two cases out of three or three out of four. I would like to answer your question, but I just do not know.

Senator ADAMS. I notice in estates that sometimes inventories are published, and sometimes in my own professional experience I have noticed men very successful in net results, had accumulated quite a lot of bad investments.

Mr. BROWN. I scarcely know of a millionaire who dies who has not somewhere in his estate—they may not be inventoried, because they are so utterly worthless—dozens of securities which have become utterly valueless. He has probably made his fortune on some one thing that did happen to hit.

Senator ADAMS. You are thinking in terms of men who are in the position of acquiring information on business opportunities. If you take the man who merely has savings, his percentage of loss will be much higher than that of the experienced man in business, would it not?

Mr. BROWN. It certainly would if he tries to go into that field.

Senator ADAMS. Everybody does.

Mr. BROWN. Most people do. I will not say, everybody. I know a few conservative souls.

Senator WAGNER. Again referring to the credit of the small-business man, did you have an opportunity to read the testimony before the so-called monopoly committee, of small-business men giving their experiences with reference to small business?

Mr. BROWN. I did not, Senator. I would say that when you hear the testimony of a small-business man, unless you take the other side of the story as to why the loan was declined you only get one side of the story. I remember at the time of the Viner investigation a man who had a perfectly good statement was turned down and the investigator who came around could not understand it. In going through the man's books we had found he defrauded the Government on income tax and filed a false return for a number of years, and he was not a good business risk—not because of dishonesty or because of defrauding the Government, but because of the danger that the Government might act against his property on a lien for income taxes.

I go back to the proposition that the only way to get at the truth in the matter is not to take ex parte statements from every small-business man. They are honest; they believe they have been turned down on credit which they are entitled to get; but you should have somebody capable of forming a judgment, to listen to the borrower, and then listen to the man who declined the loan, and then make up his own mind; and if he takes a large enough sample of such cases he will give you a pretty fair picture of how much the unsatisfied need exists.

I would like to point out the danger which exists in the present bill. It seems to me that it authorizes loans to be made without any requirement on the part of the R. F. C. or the lending agency that there is a reasonable certainty of repayment.

Senator HUGHES. That is the amendment that you spoke of awhile ago? You said that the bill ought to be amended in that respect.

Mr. BROWN. There is no need of arguing the question with the committee, if the committee feels that loans ought only to be made to businesses, which, after examination, can satisfy the agency making the loans that there is reasonable assurance of repayment. There has been some philosophy advanced that loans ought to be made irrespective of whether the business can repay them, because if loans are made to businesses which cannot repay, they may, by using the money, give employment to a lot of people and advantage the national economy more than the loss which the Government would take on the percentage of loans which are not repaid.

Senator ADAMS. Just as an individual member of the committee, I suggest that you do not restrain your views on any presumption of what the committee may report.

Senator WAGNER. At any rate, I do not recall any testimony where it was suggested that loans should be made irrespective of any prospect of repayment of the loan. I do not think anybody said that.

Mr. BROWN. The text of the law giving authority to the Federal Reserve banks to make direct loans to industry requires that they shall be adequately secured in the opinion of the bank. The test in the original R. F. C. Act was that they should be safely and adequately secured. The test now is, in the 1938 act, which was the great liberalization of the R. F. C. Act, that the investment be of sound value, or so secured as to reasonably assure retirement or repayment, and only to concerns which are in the opinion of the R. F. C. solvent when the loan is made.

If anybody under 2343 can see any requirement that the R. F. C. must satisfy itself as to the solvency of the borrower or as to the certainty of repayment, I have not been able to find it.

Senator FRAZIER. If this bill should pass, Mr. Brown, would your bank go to the R. F. C. to make a loan under this provision if you did not think there was a reasonable assurance that the borrower could pay his debt?

Mr. BROWN. I hope we would not; but I know a good many cases where it would be to our advantage to do so. We have got, for instance, a loan of several hundred thousand dollars to a closed oil refinery in Texas that is charged off. I would be delighted to double the amount of the loan to get nine-tenths of the double loan guaranteed by the R. F. C.

Senator FRAZIER. You are talking about loans which you have on hand.

Mr. BROWN. All right. I will talk about a new loan. One of the courses of our midcentral western country at the present time has been the fact that local businessmen have stimulated the building of small canneries by supplying capital to promoters on the theory that the cannery, when it is located in their town will benefit the value of surrounding real estate. I can readily see that instead of all the citizens of the town clubbing together and putting up the money, they will go to a bank and say, "You loan this fellow \$100,000, to put up a cannery which will bring a lot of business to the town, and get the R. F. C. to insure 90 percent of it. The bank may lose 10 percent, but it will mean that more money will be spent in this town and we will see you get it back some way."

That is not imaginary, Senator Frazier. There are a good many banks in this country which go into unsound loans for reasons of local patriotism.

Senator FRAZIER. And politics?

Mr. BROWN. And politics. There have been several large banks in Chicago which were wrecked because of loans made in response to political pressure. You ask me whether our bank would do it. I hope we would not; but I know perfectly well that there are a great many banks in this country that would, and it seems to me that the least that Congress can do, if it is going to set up any loaning agency or any insuring agency, is to require an inspection of the risk and a finding that there is at least a reasonable certainty of repayment.

Senator HUGHES. Do you think that if the bill is to be reported, it should have that amendment in it?

Mr. BROWN. I would say so, by all manner of means, Senator.

When a loan is made to a badly managed business or a failing business, that keeps it alive whether that loan is made by a private individual or made by the Government, it operates unfairly to all the sound concerns in that industry. We had an example in the Chicago district. There was a large radio business, and it made good radios. It was located in a small city in Indiana. It got into difficulties, and it was going to close down. Its closing down meant that the people in that town would be out of jobs. It tried to get bank loans and could not. It finally got a loan from the R. F. C. The R. F. C. tried to surround itself with every possible safeguard, but I think it was very much influenced by the fact that if the loan were not made, a lot of people would be thrown out of employment. What happened? For a little over a year in which the company made radios and sold them at less than the cost of manufacture, it absorbed the trade of the other radio manufacturers in the Middle West. It finally folded up, and the R. F. C. is now holding a mortgage on a shut-down radio plant, and the bulk of the loan will be lost. But it absorbed the profits, it absorbed the expansion plans, and it absorbed the opportunities for employment of three or four solvent competitors who were paying income taxes.

The same result would have been obtained if the loan had been made by a bank or by a private individual, as if it were made by a governmental agency. But the bank or the private individual wants to be pretty sure that the business is a success before it loans the money out, because it is going to lose its own money. The governmental agency has not got the same deterrent; and, as I say, in this bill there is absolutely no requirement of examination to satisfy the loaning agency that there is any reasonable assurance of repayment.

Just one more point, Senator. I realize that I have probably talked too much. A number of studies have been and are being made as to the need of this kind of credit, but as far as I know, none of them have been introduced before this committee; none of them are complete in themselves. I think that the committee, before enacting legislation, should make a real investigation. I understand, for instance, that the Federal Reserve banks at the request of the President's council of Federal Reserve banks have caused an examination of the need of this sort of credit. Last Tuesday the Federal Advisory Council was in session and it was told of the investigation. I do not know its result, but from what I have heard from officers of two or three of the banks I doubt if there is shown any considerable existence of an unsatisfied justifiable demand for loans as distinguished from proprietary capital. There have been local studies made by other groups, and I do think that the dangers in the implication of the Government's going into the business of direct loans to industry and commerce on a large scale are such that before legislation is passed, all of the available material should be assembled and studied and examined and correlated, and where there are gaps in it, further studies and examinations should be made.

(The witness withdrew from the committee table.)

STATEMENT OF HOWARD A. LOEB, VICE PRESIDENT, FEDERAL ADISORY COUNCIL, CHAIRMAN, TRADESMENS NATIONAL BANK & TRUST CO., PHILADELPHIA, PA.

Senator WAGNER. Shall we continue this afternoon? Some of these gentlemen have come from out of town. Mr. Smith, for instance, is from St. Louis. Can we not meet this afternoon?

Senator ADAMS. They may finish the calendar about 3 o'clock.

Senator WAGNER. I think so. We will go on until 12 o'clock, and then recess until 3.

Will you state your name and whom you represent?

Mr. LOEB. My name is Howard A. Loeb. I am vice president of the Federal Advisory Council, and chairman of the Tradesmens National Bank & Trust Co., Philadelphia, Pa.

Senator WAGNER. You do not mind if we interrupt you at 12 o'clock?

Mr. LOEB. Certainly not, Mr. Chairman.

Senate bill S. 2343 and the comments made by its proponents imply that there continues to exist a substantial demand for credit upon the part of medium-sized and small business enterprises that is not being supplied by banks, by the Reconstruction Finance Corporation, by the Federal Reserve banks under authority of section 13b of the Federal Reserve Act or by other lending agencies of the Federal Government. Little or no data in support of this statement other than an expression of opinion has been submitted with this bill, despite the fact that during the last 7 or 8 years numerous studies have been made of this subject by public bodies, banking and business groups and latterly by the Federal Reserve banks. A careful review of these reports indicates no significant volume of justifiable unsatisfied credit.

If I may be permitted at this time, I have prepared a supplementary statement supporting those conclusions, but before continuing I would like to submit some, what might be termed local, data obtained from banks in and about Philadelphia.

Taking our own bank, let me say that for the last 18 months we have kept a record of rejected loans, which I think is a very important record to maintain.

For the period of June 1, 1938, to May 31, 1939, our bank made 2,916 loans aggregating \$19,914,585—and these are all unsecured loans—an average of \$7,000 per loan. It rejected in that period 34 loans, and those loans are not so-called personal loans or small personal loans.

Senator FRAZIER. How many rejections?

Mr. LOEB. Thirty-four out of 2,916 loans made, totaling \$381,700, or an average per loan of \$13,500; a percentage of 1.16 in number and 1.91 percent in amount.

An examination of those 34 rejections is interesting. In the \$1,000-loan class there were 14 loans, involving \$9,200, of which 1 was rejected in the sum of \$1,000 because of the type of business; 3 in the sum of \$1,800 because of the history of the borrower; 10 in the total of \$6,400 because of the financial condition of the borrower.

In the next class \$1,001 to \$2,500 there were two rejections amounting to a total of \$3,500—rejected because of the history of the borrower.

In the next class, \$2,501 to \$5,000, there were seven rejections, because of financial conditions, involving a total of \$34,000.

In the class of \$5,001 to \$10,000 there was one rejection because of financial condition.

\$10,001 to \$25,000, one rejection because of history.

In the \$25,000 to \$50,000 class there were two because of the type of business. They amounted to \$100,000.

In the class of over \$50,000 there was one loan in the sum of \$200,000 because of financial condition.

This only covers, as I said before, what we call our unsecured loans. In addition to that we have made loans on commodities, loans on collateral of various kinds and a small amount of automobile financing. These are all in the category of secured loans.

Senator WAGNER. What do they amount to?

Mr. LOEB. They amount to \$1,483,435.

As to some of those loans we have participations with other banks.

Senator ADAMS. What about participation with the R. F. C.?

Mr. LOEB. We have one participation and one stand-by, and we have agreed to continue to afford the borrower a line of credit under certain limitations which have been agreed upon by the borrower, the R. F. C., and our bank.

Senator WAGNER. How long are these loans for?

Mr. LOEB. They are current loans for relatively short periods. On that subject I think you must realize that these so-called short loans are not really short loans, and there is a certain advantage and stability afforded to the whole industrial situation by having these loans mature at shorter periods, so that the borrower as well as the lender may have the value of conferences. These conferences result in information of value both to the borrower and to the lender. Information is developed that frequently enables the lender to be of further assistance, not only to the particular borrower, but furnishes the lender with information leading to a broadening of loan activities.

Senator WAGNER. You make them for how long?

Mr. LOEB. They vary, Senator. I have not broken that down, but I should say all of these loans except our participations are for within a year.

Senator WAGNER. Have you any information there as to how far the loan was really extended?

Mr. LOEB. Obviously, with 2,916 loans we are designating each loan as it matures and is renewed, a new loan, because it has matured. That in itself will give you some idea of the length of time involved in the loan.

Senator WAGNER. What I was trying to find out was, while the loan is for 6 months, say, what is your average loan? How many renewals are there? Have you any information on that?

Mr. LOEB. No; I have no information on that, except the general information that under the tremendous pressure that banks are suffering today with unloaned funds and exceedingly low rates, every effort has been made to keep, where it is reasonably safe, money in operation; so that that old idea of short maturity—because a note happens to have a short maturity, is not in effect a short maturity.

Senator WAGNER. What is the rate of interest charged?

Mr. LOEB. I should say that the average rate is around 3 percent on our commercial-loan portfolio.

In addition, I would like to submit a piece of publicity issued by a much larger bank that struck me as very interesting and as indicative of the attitude of banks, and I should like to read this rather fully, because it helps clear up an impression which is much to the contrary [reading]:

There is a current impression that banks do not want to lend money. This may be due to a lack of information. The larger part of the bank's income is derived from interest on loans.

Every bank has two plain duties: First, to safeguard the depositors' money—that means it must make "safe" loans—second, to provide the public with the most helpful financial service possible.

This bank—and we are sure the vast majority of other banks—is glad to lend money and is seeking good loans. Our record is evidence of it. During the past 12 months, we have loaned a total of \$81,902,685, made up of 39,674 separate new loans.

Eighty-four percent of these loans were in amounts of less than \$1,000. We mention this to show our interest in serving the man or woman who may need as little as \$100, as well as the large business concern borrowing in the thousands.

As part of this plan of rendering a really constructive banking service, the bank maintains special departments devoted to handling five broad types of loans which cover almost every human need.

Commercial loans.—This department finances the needs of business. It serves merchants and manufacturers, large and small, local and national.

Collateral loans.—This department makes advances at attractive rates of interest on the security of bonds or stocks.

Time sales.—This division serves many business concerns that sell merchandise on deferred payments. It purchases installment contracts from public utilities and dealers in automobiles, furnaces, refrigerators, stoves, etc.

Personal loans.—A business-like, courteous service for making loans to individuals, repayable by monthly deposits. Six percent of the amount borrowed is the charge for the entire year and the monthly deposits receive the bank's regular saving-fund interest rates. Amounts from \$100 upward are loaned.

Home financing.—The bank is paying its part in home financing. Our services are available to those interested in owing a home, building a home, making improvements, or refinancing mortgages.

During the past 12 months, the bank has made the following new loans:

3,384 commercial loans-----	\$34, 070, 424
5,164 collateral loans-----	33, 566, 602
21,409 installment-sales loans-----	10, 221, 135
4,416 personal loans-----	1, 209, 112
5,301 Federal Housing Administration, mortgage, and construction loans-----	2, 835, 412

Summary (excluding loans on our books at the beginning of the 12-month period), 39,674 loans aggregating----- 81, 902, 685

An average of \$2,000 per loan.

In a study that was made as of April 19 on loans of 27 member banks in the third Federal Reserve district, the banks being located in Philadelphia, Camden, Scranton, and Wilmington, this information is revealed. This covers 819 loans aggregating \$23,566,300.

Broken down, the installment loans with a final maturity of 1 year or more, but less than 3 years, were 380 loans aggregating \$5,707,900, or an average of \$15,000 per loan.

With final maturity 3 years or more from date of loan, 324 loans aggregating \$13,690,200, an average of approximately \$42,500 per loan. They were installment loans.

Other loans with a maturity of 1 year or more, but less than 3 years from date of loan, 88 loans with a total of \$2,710,000, an average of \$31,000.

Loans with a maturity of 3 years or more from date of loan, 27, a total of \$1,458,000, or an average of \$54,000 per loan.

The further interesting fact is revealed that in a break-down of those loans, out of a total of 819,000, 767 were loans of less than \$100,000, or an average of \$11,500 per loan.

Fifty were for sums between \$100,000 and \$1,000,000, aggregating \$12,814,000, or an average of \$250,000 per loan.

There were two loans of a million or more, averaging \$1,000,000 each.

I present those figures at this time to show what the banks are really doing to meet loan demands. I would like now to proceed—

Senator WAGNER. Maybe this would be a good place to stop, Mr. Loeb, until 3 o'clock.

(Whereupon, at 12 o'clock noon, a recess was taken until 3 p. m. of the same day.)

AFTERNOON SESSION

The hearing was resumed, pursuant to the recess, at 3 p. m.

Senator WAGNER (chairman of the subcommittee). The subcommittee will resume. Mr. Loeb, you may continue your statement.

STATEMENT OF HOWARD A. LOEB, VICE PRESIDENT OF THE FEDERAL ADVISORY COUNSEL, CHAIRMAN OF THE TRADESMENS NATIONAL BANK & TRUST CO., PHILADELPHIA, PA.—Resumed

Mr. LOEB. I just want to add a comment to the group of statistics I read this morning, that is fairly indicative of the loan activity in the third Federal Reserve district. That district, as you no doubt already know, embraces that section of Pennsylvania east of Johnstown, and that portion of New Jersey south of Princeton, and the State of Delaware.

Despite the fact that through most active publicity and personal solicitation, with huge volumes of unused funds pressing for use, banks are continually seeking loans at unprecedentedly low rates of interest and for periods of time, the propriety of which considering the problems and vicissitudes of business, are debatable, the impression persists. It continues despite the fact that the Reconstruction Finance Corporation, with the enlarged powers granted under the amendment of April 13, 1938, is making loans in relatively large numbers and volume, subject only to the reservation that such loans must be "of such sound value or so secured as reasonably to assure repayment or retirement" and to borrowers "only when in the opinion of the board of directors the business enterprise is solvent."

It has been my privilege to serve as a member of the advisory loan committee of the Philadelphia agency of the Reconstruction Finance

Corporation since its inception some years ago, and throughout that entire period, in considering loans, a spirit of sympathetic understanding of the borrowers' problems has prevailed. Its accomplishments in meeting the demand for credit throughout the period are significant.

I would like to add here that the Reconstruction Finance Corporation particularly within the last 2 years when an application is made for a loan which it thinks is too large in amount, or the conditions are not proper, does not reject the loan flatly. It confers with the borrower to see whether his problem can be readjusted in terms which will permit the granting of the loan. I think that is a very important contribution to the easing of any tension, or I might say meeting any contention that there are credit restraints.

The Federal Reserve banks, within the limitation of section 13 (b) of the Federal Reserve Act, and the Reconstruction Finance Corporation have played an important part in meeting credit demands of a character that for one reason or other banks cannot make. A careful review of the reports of the Reconstruction Finance Corporation and the Federal Reserve Banks with regard to loans to business enterprises will reveal their activities in this field. An analysis of the record of these agencies will disclose not only the volume and character of loans made, but also the reasons for refusals of loans. Further reference to these reviews is contained in my supplementary statement.

Now, I think that is something that should be stressed. These refusals frequently loom up in fairly important numbers, but when the amounts are considered are not so important. I think there would be a considerable contribution to the information surrounding this whole question if a more careful review were made by some competent authority of the reasons for rejection of loans. In this supplementary statement I referred to before, a review is contained of that situation.

Regardless of the findings of the groups hereinbefore mentioned or the opinions of the proponents of the Mead bill, I urge that the Congress make its own study "of the extent to which existing agencies meet the need for term loans on the part of business and of the extent of the unsatisfied justifiable demand for such loans." It may be appropriate that it be made a part of the study of the entire banking system suggested by the Board of Governors of the Federal Reserve System. The delay involved in such a program will cause little, if any hardship. The existing powers of the Reconstruction Finance Corporation are as extensive as those granted under S. 2343 and are more attractive to banks, both from the standpoint of participations and insurances. Furthermore, there is no limitation on time of repayment of loans made by the Reconstruction Finance Corporation under present authority. I am assuming that the requirements of ultimate repayment by and the solvency of the borrower are not to be waived under S. 2343, although the bill is silent on these points. I am of the opinion that under the conditions imposed in S. 2342 banks would not be disposed to make loans because of the initial loss provision.

In the meantime, if for no other reason than because of pressure of large volumes of unused funds and low earnings, banks may be

relied upon to continue to exert their efforts to meet justifiable unsatisfied demands for credit. The Federal Reserve banks and the Reconstruction Finance Corporation would continue their activities in this field.

Such investigation as is suggested will of necessity embrace the study of many correlated subjects. Primarily a demand for credit should not be confused with a demand for equity or enterprise capital. The former can be repaid over a relatively short period of time from the seasonal demands of business and out of profits. Equity capital, even in the case of enterprises that are of more than average earning power, is subject to much slower repayment because of the necessity of using profits for development, to meet depletions, obsolescences, and the vicissitudes of business. Such an investigation might properly include the following phases of the subject :

1. Why, with huge volumes of credit and/or capital available at very low rates and upon extended repayment terms, are borrowers reluctant to borrow and investors unwilling to invest?

2. To what extent would additional borrowing, that it is hoped will result under S. 2343, stimulate general business recovery, keeping in mind that present producing capacity of business not suffering from lack of credit or capital is far in excess of present demands?

3. To what extent would loans granted to business having doubtful managerial capacity, regardless of solvency at the time of making the loans, have a depressing effect upon business because of dislocations arising out of inadequate management?

4. To what extent are small or relatively small businesses adversely affected by the rigid provisions of regulatory acts of Government, whether Federal or State?

5. To what extent is the demand for credit and/or capital affected by the character and the volume of taxation?

6. To what extent is the demand for credit and/or capital affected by consideration of consistent profitable use thereof?

Finally, it would seem appropriate at the same time to ascertain the effect upon recovery of loans already made in substantial amounts at low rates of interest and upon extended repayment terms by governmental and private agencies. It would also seem appropriate to inquire into the effect upon recovery of the continuation and further extension of such a policy.

Now, with regard to the resolution of the Federal Advisory Council I have only a few remarks to make.

A copy of the resolution of the Federal Advisory Council of the Federal Reserve System in re S. 2343 has been filed with your committee. As a member of the Council I fully endorse that resolution.

Briefly, I should like to comment on a few of the features of S. 2343.

As I have hereinbefore stated, I am assuming that the gages of capacity of repayment and solvency of borrowers now used by the Reconstruction Finance Corporation are not purposefully omitted from S. 2343. However, if the omission is intentional, I seriously question whether banks would be stimulated to make marginal loans on the theory that only 90 percent of the net face amount of the loans would be guaranteed by the Reconstruction Finance Corporation. Banks so inspired would suffer heavy losses—probably beyond those they could safely meet without endangering their stability. On the other hand, if the Reconstruction Finance Corporation were to guarantee 90 percent of each such loan, the insurance charge of one-fourth

of 1 percent to 1 percent would not compensate it for losses sustained. In support of this conclusion reference is made to the experience of several of the Federal Reserve banks in the cost of servicing and losses encountered in loans to business under section 13 b, and to the experience of the Reconstruction Finance Corporation. On the other hand, if the Reconstruction Finance Corporation, in order to reduce the insurance hazard under S. 2343, required banks that desire to avail themselves of the insurance provision, to include loans which the banks were satisfied to carry on an uninsured basis, there would be no incentive to make marginal loans.

It is not likely that banks will apply for insurance of loans in which they have confidence. The Reconstruction Finance Corporation, therefore, would then be confronted with the problem of taking only doubtful loans under the insurance plan.

As the resolution of the Federal Advisory Council correctly states, even though the Reconstruction Finance Corporation were willing to extend insurance on loans of this type, disturbance to the business situation would result. Sound business enterprises would be faced with unsound competition, causing progressive weaknesses, resulting in a demand for further extension of unsound credit. The losses sustained would be borne by government, and subsequently repaid through taxation.

Section 5 of S. 2343 provides for the rediscounting of insured loans by the Federal Reserve banks whether offered by member or non-member banks of the Federal Reserve System. This seems to me to be an unwise proposal insofar as it will open the door to continuous borrowing upon the part of member banks unless regulations prescribed by the Federal Reserve banks provide otherwise. If this section is intended to provide for the proper use of the rediscounting of insured loans by the Federal Reserve banks, then the present broadened eligibility rules of the Federal Reserve System provide ample opportunity for making advances on such loans. In the interest of banking stability, it is highly important that member banks be not continuously indebted to the Federal Reserve banks for as long periods as would be possible under the provisions of section 5 of S. 2343.

That is the conclusion of my main statement. I have a supplemental statement that bears on the experiences of the Reconstruction Finance Corporation, Federal Reserve banks, and some comment on studies made of this credit situation recently and in previous years. I will be glad to read it if you would like to have me do so.

Senator WAGNER (chairman of the subcommittee). You might file it with the subcommittee. We will want to ask you some questions now.

(The supplementary statement referred to by the witness appears at the end of his testimony.)

Mr. LOEB. All right, Mr. Chairman.

Senator WAGNER. I believe you said that you have very few loans in your institution in which the Reconstruction Finance Corporation has participated?

Mr. LOEB. In which we participate, or we participate in the take-back. We have only one at the present time. We have not had any occasion for them. On the only two occasions where we participated they were clients of the bank. In all other cases it is because our cus-

tomers did not find it necessary to avail themselves of loans from the R. F. C.

Senator WAGNER. It was not a case of the R. F. C. itself being unwilling to participate?

Mr. LOEB. No, sir. In our experience it just so happened. I do not have a review of the extent to which participation has been made by other banks in Philadelphia, although I know as a member of the Advisory Loan Committee that there are a number of such participations, and they usually arise from participations as a result of previous relationship between bank and borrower. Sometimes even the position of the bank is subordinated to the Reconstruction Finance Corporation, depending, of course, upon the particular problems involved in the particular credit.

Senator WAGNER. What I had in mind, and perhaps I should have waited until I got more definite suggestions, was a statement made that the R. F. C. now has authority to make loans on very liberal terms, and particularly insuring the bank where the bank participates; and yet your bank only shows one such loan, and I do not recall just what Mr. Brown said about his bank, but I know there were very few loans that that bank made in which the R. F. C. participated. Now, it might be there was no demand for loans, but I do not know as to that.

Mr. LOEB. I cannot answer categorically except with regard to my own bank.

Senator WAGNER. Do you know that there are participations of that kind?

Mr. LOEB. Yes, sir. But they largely arise where the borrower is a client of or has been a borrower from a particular bank. In other words, that would seem to me to be the more normal way in which those participations would be taken. For instance, the question of a loan comes up and they will see from the record that certain banks have been depositaries of the particular borrower, and that they have loaned money, and they will confer with those banks. Frequently the banks will take participations, or take the whole loan on a take-back of 50, 75, or 90 percent, subject to the insurance. Of course, in that case losses would be shared in the participation proportions. The banks do not take the initial loss.

Senator CLARK of Idaho. In the ordinary case if the loan is sound and a fairly desirable loan you make it. If not, you do not want the R. F. C., as a rule, or anybody else, to go in and make the loan.

Mr. LOEB. Not unless we have had a previous relationship with the borrower.

Senator CLARK of Idaho. Unless there is an unusual circumstances?

Mr. LOEB. Yes, sir.

Senator CLARK of Idaho. Unless the loan is too large as one single loan. But by and large if the loan is not sound you do not want it on any basis?

Mr. LOEB. No, sir.

Senator CLARK of Idaho. And if it is sound you are perfectly willing in the ordinary instance to make it?

Mr. LOEB. Yes. I want to go a step further to show the degree of cooperation banks try to give in helping out in these situations, where a bank is in a situation it will go into participations—

Senator CLARK of Idaho (interposing). Yes; and that has been done frequently.

Mr. LOEB. Quite frequently. I do not want you to get the impression that R. F. C. loans are without bank participation.

Senator CLARK of Idaho. It is for some other reason than their soundness.

Mr. LOEB. They are prompted to work out the credit.

Senator DANAHER. Mr. Chairman, might I ask a question?

Senator WAGNER (chairman of the subcommittee). Certainly.

Senator DANAHER. I would like to direct the witness's attention to section 5, subparagraph b, on page 6, line 4, of the bill. You will notice the interpolation of the words "or abroad." That section reads:

Every Federal Reserve bank shall have power to buy and sell, at home or abroad, obligations evidencing loans insured under this act.

Have you given thought to the extent to which that language might be applied?

Mr. LOEB. I do not quite get the point of buying abroad.

Senator DANAHER. Perhaps that is why I asked the question. I do not know either.

Mr. LOEB. I am not sufficiently familiar with that side of it. I think that is just one of the things put into the bill and it does not mean anything to me.

Senator DANAHER. Do Federal Reserve banks today have the power to buy obligations abroad?

Mr. LOEB. Member banks?

Senator DANAHER. Whatever the term means.

Senator HUGHES. Does it not mean loans under this law?

Mr. LOEB. I should think it confines it to that.

Senator DANAHER. Does a Federal Reserve bank today have the power to buy paper evidencing obligations abroad?

Mr. LOEB. Under this act?

Senator DANAHER. No; under the present act, under the powers of Federal Reserve banks.

Mr. LOEB. I think so.

Senator HUGHES. This confines it to loans insured under this bill.

Mr. LOEB. Exactly.

Senator DANAHER. Under this particular bill itself?

Mr. LOEB. Reference to the act itself will show. It may have been put in here as an extension of the provision giving the right to buy and sell bills abroad.

Senator DANAHER. I want to know why that power is granted to your banks. Do you know?

Mr. LOEB. I do not.

Senator HUGHES. Can Federal Reserve banks buy or sell loans?

Senator CLARK of Idaho. They are given the power to buy and sell obligations evidencing loans.

Senator HUGHES. I would like to know about that. Mr. Loeb, there is complaint I hear often about rates of interest, and I suppose that applies to some sections, of the difficulty of getting small loans on account of the high rate of interest. I take it there is nothing of that kind in your district. Your rate of interest you said ran 4 or 5 percent.

Mr. LOEB. Our average is under 3 percent. There may be a case here or there but it would be an unusual circumstance, where the rate is about 5 percent. It may be highly desirable to get more but competition does not permit of it.

Senator WAGNER. Do you make any outright loans for a period of, say, 10 years?

Mr. LOEB. We have not, but the banks in our area have. We have some loans that we know will be going on for perhaps 10 years, but they were not made as a fixed contract.

Senator WAGNER. Do you know what rate of interest is charged for such periods?

Mr. LOEB. I know they are too low. I think we are all agreed there again as to the tremendous eagerness, evidenced by the rate of interest that exists in the case of these loans. I have heard of some of them for 5 years as low as 2 and $2\frac{1}{4}$ percent. I think there are some lower than that made lately for longer periods of time. Of course they are subject to reductions, but all these rates are effective by reason of the unusual surplus of money.

Senator WAGNER. A number of small-business men's organizations have met here and at other places, and there has been voiced in the meetings complaint that they cannot get sufficient credit. That is what has brought about this movement for more liberal loans for small-business men. How do you account for that activity?

Mr. LOEB. Well, I think that is something of a mass statement, where people subscribe to it but are not in any way the victims of it. These things arise because of a sort of mass psychology. The statement is made and then the crowd gets up and cheers. The way to meet it is not to take what is tantamount to an unjustified clamor but to go ahead and make an ex parte investigation of the situation. That has been done not only by banking groups and business groups but also by educational groups. It has been done, as Mr. Brown indicated, by the Treasury 2 or 3 years ago. It is true it was only in the Chicago district, but there is a way of ascertaining the facts, and when ascertained you will know whether injustice has been done.

Senator WAGNER. I think Mr. Eccles also stated there was a gap.

Mr. LOEB. Senator Mead in presenting this bill said there was a gap, but it is not supported by any evidence.

Senator HUGHES. The theory of this bill, as I understand it from the standpoint of the borrower, is that it would induce the loaning of money which is now in large quantities tied up in banks, would loosen up credit; that banks would be induced to make these loans and be more liberal about them by having 90 percent of a loan insured by the Government. I want to ask you this question: Do you think it would have that effect? In other words, would banks risk 10 percent on a bad loan because 90 percent was insured by the Government? Or, I should say, make a loan that was not as good as they would ordinarily select if they were making the loan themselves?

Mr. LOEB. No; I do not think so.

Senator HUGHES. You think from the standpoint of the bank it would look at the possible loss of 10 percent?

Mr. LOEB. Yes, sir.

Senator HUGHES. They would stand the chance of losing 10 percent but they would not be losing any more than they do now.

Mr. LOEB. I am practically sure of that from a survey I caused to be made of medium-sized city and country banks in their reaction to this bill. I have that data here. I cannot mention the names of the banks, but I have the statements they made, and not a single one could see how this would in any way stimulate lending.

Senator HERRING. I think the one Mr. Eccles referred to is the same one Mr. Brown referred to here this morning—these relatively small loans you are unable to make to affiliates now which cannot stand the expense of going through the R. F. C. The charge is so high in order to finance \$200,000 worth of bonds they cannot afford to get the money that way. There is perhaps a gap in there you are unable to meet now.

Mr. LOEB. There might be an area there, but you must keep in mind that is in the area of enterprise, or risk capital, which was in the past but not always completely taken up by local individuals. I have been in the banking business for over 30 years, and have gone through quite a period of varying history and development. I recall that in the old days I would always have on my desk applications from men who were either retired from business and would want to get back again, or who would want to put a son in business, in amounts from \$10,000 to \$100,000, and would ask me for opportunities to reinvest money to get into business. Of course they took the risk and got more than the loan rate. That condition in the past 5 years has practically disappeared.

Now, there are some things there that might well be investigated. It is not because there is an absence of that kind of money but because of a change in disposition. I think that is one thing it is so important to determine. Why, with all these devices we have set up, that condition persists. With the huge volume of money at very low rates, with the Government lending activities on a very broad and extensive scale, this condition still persists. That is the thing I think you would find out if this investigation were made, and it would have to be made by ex parte groups dedicated to the proposition of determining just what, if anything, is wrong and how it can be corrected.

There are some groups that say we have gone too far in our reform legislation, that it is pressing down on recovery. It is easy enough to make that statement but it must be supported by intelligent investigation. Whether that is the case or not would be determined by such an investigation.

Senator WAGNER. Referring again to what Senator Herring said, that type of credit Chairman Eccles referred to, that is, inability to secure credit for longer than 10 years, which is really investing—

Mr. LOEB (interposing). That is a misuse of terms. We are never going to understand this thing, and the public will not understand it, unless we use correct terms.

Senator WAGNER. He does refer to another category: Chiefly enterprises which would be doing better if business activity were more fully restored, but which, with business at its present level, represent a degree of risk that banks quite rightly hesitate to undertake unassisted. They are not enterprises that have been mismanaged, or possibly ill-advised, but merely those whose business, either because it is new, because it is peculiarly affected by present business con-

ditions, or for some other reason, are not at this time able to secure credit from the banks. With the existing volume of unused funds, banks are eager to make all the loans they can, but their responsibilities make many of them hesitate about extending credit to concerns in this category.

Mr. LOEB. Well, that is a statement. It is not supported by facts based upon my own experience, but that does not say there are not occasions of that kind.

Senator WAGNER. But from your own experience you do not know of these cases?

Mr. LOEB. No. There might be a case here and there. Sometimes it is due to unintelligent presentation. You can never hope to establish a system in which there is not going to be a case of justifiable credit that is not obtained. That is not necessarily the fault of the lender. Perhaps it is a lack of intelligence, or a lack of capacity of proper presentation upon the part of the borrower.

Senator WAGNER. We are not finding fault with you on that.

Mr. LOEB. You cannot so far as justifiable loans are concerned. I realize in making that statement it is made as the result of such investigations as I have either participated in or reviewed; there is no substantial volume of justifiable loans that are not taken care of. When you get into the field of enterprise capital you are entering another field altogether, and I do not take it this bill is to guarantee enterprise capital.

Senator DANAHER. This morning the witness testified that his bank has made 2,916 loans involving more than \$19,000,000. May I ask whether or not the most of those include what you would consider consumer-goods types of businesses?

Mr. LOEB. Well, no; I should not say that. Let me see—I think perhaps the most of them are in what we call consumer activities. But there is a proportion in what might be termed capital- or durable-goods loans.

Senator DANAHER. Are not the most of them what we are trying to consider, small businesses?

Mr. LOEB. The average is \$7,000. The field is being covered by these loans, with the average of \$7,000, and that does not include personal loans. Those are not in the category of unsecured loans.

Senator DANAHER. So it is fair to say that the overwhelming plurality of that type of loans does involve small businessmen and merchants who are dealing generally in the consumer-goods field?

Mr. LOEB. I think it does.

Senator WAGNER. Does this represent primarily working capital?

Mr. LOEB. Working capital for the time being. It adds to the borrower's working capital for the purpose of facilitating his business activities.

Senator WAGNER. Perhaps I should have made myself more clear. Does it represent money to carry on the business as it exists mostly, or does it include in some cases construction of additional plant or buildings?

Mr. LOEB. Yes. There would be a proportion of those loans so made. I have not had them studied, however, from that standpoint.

Senator WAGNER. They would be smaller in amount.

Mr. LOEB. A borrower may come in and say he has to borrow money for additional machinery. That loan will be made for 6 or 8 months; or it may be to take care of obsolescence and depreciation.

Senator WAGNER. As to the larger enterprises they go out into the market and sell bond issues to secure their money.

Mr. LOEB. In case of the very large corporations, yes.

Senator WAGNER. And they get the money for long periods of time, of course?

Mr. LOEB. The period of time is not really disturbing the borrower. As I said this morning, I think it is something that should be carefully observed. More frequent conference in connection with the renewal of a loan is of vast value not only to the borrower but also to the lender. Such conferences enable borrowers and lenders more intelligently to solve not only credit problems but also business programs, resulting in greater stabilization in business, with a consequent reduction in failures.

I think there again there is some misunderstanding as to what we might call a short loan and a long loan. Country banks, they make them for short periods, but they endure frequently for long periods in many cases. And I am not in any way criticising the value of them. But it is the frequent conference between borrower and lender that is of great value. And I have not found in this group of loans that there is any quarreling over or any discussion about the matter of time. There is really no demand in the case of ordinary loans of this kind for long loans. If you are going to stress the matter of long loans you may introduce a factor in borrowing that may some day work to the disadvantage of the business situation.

Senator WAGNER. What I was thinking of was where a man has a department store and he thinks his business justifies expansion and he builds another plant, or another store almost as large as the one he was operating before the loan was secured. Is it not really a hardship if he has to amortize that loan within a period of a year or a year and a half, a loan that rather represents a large investment in his business?

Mr. LOEB. That would of course depend upon a review of his credit statement. It might be a hardship if the amount he has put in is too large a proportion of his so-called free capital. On the other hand it might be borne out of income. In other words, if it is more than he has the right to contract to pay out within a given period of time under the normal profit expectancy from his business.

Senator WAGNER. But over a period of 10 or 15 years he would have no difficulty in paying off that loan, but he might hesitate about paying it off in a shorter time.

Mr. LOEB. That involves the question of management.

Senator WAGNER. How about credit there?

Mr. LOEB. Let me see if I understand your question, and I do not think I do.

Senator WAGNER. Let us assume I have a department store and I come to you for a loan. You have watched my business and think I am doing all right. I tell you I want to get a loan, say, of \$15,000 or \$20,000, because I want to build another building, but the most of my investment is in the business and my income is not enough if you call upon me within 6 months or a year to pay it. But if I

have a period of 10 or 15 years, as one does have in the case of a mortgage on his house, I will have no difficulty in meeting that loan.

Mr. LOEB. Obviously that would be treated and should be treated as a time loan.

Senator WAGNER. Could I secure that loan from your bank?

Mr. LOEB. Yes. As a matter of fact we have a loan somewhat along that line. It is not an extension of a present department store, but a department store in Harrisburg is buying a department store in Chambersburg, and requires capital to do it. The whole thing is shown in his statement. He cannot undertake to pay that money within 6 months, so a repayment period is arranged for that loan in which he can comfortably meet it.

Senator WAGNER. Has that individual, like the example I just gave you, any difficulty in getting credit for a period of 10 years?

Mr. LOEB. Well, that would depend on whether it required 10 years to pay it. He might have that thought, but it might be the judgment of the lender that a shorter period is proper. I do not think it is that group that is suffering from credit restraint in the lending competition of today.

Senator ADAMS. Your deposits, which of course constitute the bulk of your loanable funds, are payable either on demand or upon not more than 60 or 90 days' notice, are they not?

Mr. LOEB. I can give you those figures offhand. Our deposits are in the neighborhood of about \$45,000,000. We have two central city offices and three branches located in small retail and residential districts. Of the \$45,000,000, five million are savings funds and about three or four million time funds, and all the rest are demand deposits.

Senator ADAMS. And the time funds are subject to withdrawal within 60 or 90 days I take it?

Mr. LOEB. Within 30, 60, or 90 days.

Senator ADAMS. What justification could a bank offer to a depositor, to whom it is obligated to repay his deposit on short time, in marking 10-year loans?

Mr. LOEB. There are two points to consider: Good bank management would always determine what might be termed the normal fluctuation of deposits. Good management would never tie up and there would be no demand today to tie up unduly large amounts in such loans as compared to the deposit liability. Then as has been correctly stated, we feel the loan facilities of the Federal Reserve System, under broadened eligibility, reduces any such danger.

Senator ADAMS. And you pay interest when you go to a Federal Reserve bank?

Mr. LOEB. Yes, sir.

Senator ADAMS. It costs you every time you go there.

Mr. LOEB. Yes, sir.

Senator ADAMS. So that if for one reason or another you have heavy withdrawals it penalizes your stockholders perhaps, and even beyond that your depositors?

Mr. LOEB. That might occur at some future time, but today the unloaned funds in banks are so heavy that one could tie up quite a lot of deposits without having recourse to the Federal Reserve System.

Senator ADAMS. Primarily the obligation of a bank is to maintain the funds of its depositors so that they may be returned either

under normal or abnormal conditions. That is, so far as you are justified in making longer-time loans it is only within the limits of where you are sure deposits will not be called for.

Mr. LOEB. I would like to call attention to the words I used advisedly. I am reading the first part of the paragraph: Despite the fact that through most active publicity and personal solicitation, with huge volumes of unused funds pressing for use, banks are continually seeking loans at unprecedentedly low rates of interest and for periods of time the propriety of which considering the problems and vicissitudes of business, are debatable, the impression persists.

Now, the debatable part is the question whether we may go too far, perhaps not presently but we may be going too far in tying up deposits in long-time loans. I recall distinctly in 1930 and 1931 when bankers came down to Washington and they were met with the charge that they had by one device or another gotten the people under an unconscionable burden of debt. Well, I do not believe they did it maliciously or consciously, but we got into the thing. Therefore I feel the propriety of tying up for 3, 5, or 10 years of demand moneys, even though lending facilities are afforded, is subject to careful consideration. The reason we do not give it all the consideration today that we should is because we have such huge volumes of unused funds on hand.

Senator ADAMS. Of course, throughout the country more or less there is complaint about the banker. They say: here are fifty-odd-billion dollars of deposits, and the bankers have all this money and they are not lending it. That is not the bankers' money, with the exception of their capital, surplus, and undivided profits. You are under certain obligations and the community is not entitled as I see it, nor is the Government entitled, to demand that the banker make a loan or a series of loans which are not of the kind consonant with your obligation to your depositors. The banker is running a private institution based on a contract between the bank and the depositor for the repayment of his deposit.

Mr. LOEB. Over a period of time, of course, variations in deposits, or withdrawals banks are subjected to, can be pretty well charted short of some upheaval or cataclysm.

Senator ADAMS. It was not chartered in the past.

Mr. LOEB. I admit the future has many questions.

Senator ADAMS. We have seen a change of \$20,000,000,000 in bank deposits in the last 6 years.

Mr. LOEB. Do you mean increase?

Senator ADAMS. From the low point to the high point.

Mr. LOEB. And that carries us into another question, as to how we have done it.

Senator ADAMS. Have you had occasion to read the last paragraph of S. 2343? There is a provision that Federal Reserve banks shall have power to buy and sell, at home or abroad, obligations evidencing loans insured under this act.

Senator WAGNER. That question has been asked.

Senator ADAMS. Oh, well. Never mind.

Mr. LOEB. I think there is a source from which you can get information. But if I were asked to explain it I would say I suppose it follows something that is in the present act, that it broadens that

power out to include these bills with other authorized bills. That is just one thing that happens in the drafting of a bill, because the act provides this right as to other instruments.

Senator ADAMS. It occurred to me that it took in a good deal of territory.

Mr. LOEB. I think it is just one of the things that would not happen. That is all. The trend is the other way as far as the abroad part of it is concerned.

Senator WAGNER (chairman of the subcommittee). You may proceed.

Mr. LOEB. Mr. Chairman, I will be glad to leave this draft that I have here, which is a supplementary statement covering the results, or my judgment of the results of some of these investigations, and it is a particularly interesting bit of information. It is a summary of the findings of the Federal Reserve Bank in Philadelphia, just completed, which to my mind was a most intelligently done piece of work, and really tried to cover the situation in as accurate a way as it could be done, and more particularly because it gave time and attention to a study of the rejected credits, which I think is the important thing.

Senator WAGNER. I believe this morning you said you had a less than 1-percent reduction.

Mr. LOEB. That was my bank.

Senator WAGNER. Could you give us just the conclusions of that survey?

Mr. LOEB. May I read the Philadelphia bank survey?

Senator WAGNER. It seems to be pretty long.

Mr. LOEB. It is only about half a page. If you want me to do so I can leave it with you.

Senator WAGNER. Go ahead with that part of it at least.

Mr. LOEB. It is as follows:

The analysis of data from business concerns in the Philadelphia Federal Reserve District shows that 361 of the 380 replying establishments, or 95 percent, do not desire credit or equity capital under the prevailing business conditions. * * * The principal obstacle to borrowing currently seems to be the lack of confidence on the part of both the lenders and the borrowers. A small proportion of the reporting concerns—42 of the 380 returns—have advanced some suggestions as to the ways and means of overcoming the existing difficulties, but these suggestions do not seem either to be novel or to touch the heart of the problem. * * * A few of these respondents would attempt to implement these suggestions through some legislative action, including the creation of new agencies, extension of the lending powers of the existing agencies, guaranteeing loans made by commercial banks, and changing the present registration requirements on new capital issues. * * * The basic need seems to lie in the stimulation of the flow of capital into the productive channels of private industry. But this flow, especially of venturesome capital, appears to have bogged down, and the problem is how to remove or lessen the obstacles and to quicken those forces which actually stimulate business recovery, promote the use of capital, and increase employment and income. * * * The scope and character of the information so obtained from banks may be summarized as follows: Those small businesses and a few larger ones in need of funds represent primarily establishments whose condition is such as to provide no sound basis for bank credit. For the most part permanent or fixed investment capital is required, rather than bank credit. * * * A number of bankers look with favor upon recent changes permitting purchases of small local bond issues whose marketability is limited but underlying assets and earning prospects are reasonably satisfactory.

The possible volume of such securities is indeterminable but the steps taken in this respect may ease the situation in some communities. * * * With large resources on hand, banks universally are searching new fields where their idle funds can be safely and profitably employed. For that reason there appear to be comparatively few cases within the scope of grantable bank credit that commercial banks are not willing to consider. The change in the point of view in this respect has been rather significant.

From my own observations, and in talking with bankers in going over banking situations, my fear is we may have gone just a little too far in long-time loan activities.

Senator HUGHES. What territory did you say you cover?

Mr. LOEB. The Third Federal Reserve District covers the area of Pennsylvania east of Johnstown, New Jersey south of Princeton, and the entire State of Delaware.

Senator WAGNER (chairman of the subcommittee). We thank you, Mr. Loeb.

(Thereupon Mr. Loeb left the committee table.)

SUPPLEMENTARY STATEMENT SUBMITTED BY HOWARD A. LOEB, MEMBER OF FEDERAL ADVISORY COUNCIL, REPRESENTING THE THIRD FEDERAL RESERVE DISTRICT, JUNE 13, 1939

While there must necessarily be concerns, as there always are even in prosperous times, whose demands for funds may not be satisfied, the general assumption that there is a large unsatisfied demand for credit is questionable in fact. Sufficient data are available to show that the experience of the lenders and borrowers during recent years does not support such a belief or impression. On the contrary, it indicates that the unsatisfied demand for credit is relatively small and that efforts to liberalize credit standards and practices further will undermine the credit structure by forcing funds into a class of enterprise which may constitute questionable risks.

A. Under section 13b of the Federal Reserve Act providing for the extension of credit up to 5 years' maturity to provide working capital to established industrial or commercial business the 12 Federal Reserve banks, from June 19, 1934, to May 17, 1939, received 9,424 applications for a total amount of \$404,105,000.

The initial review of these applications was made by industrial advisory committees which under the law consist of active businessmen who are not bankers. The committees recommended for approval 2,997 applications, or about 32 percent of the total originally received, for the amount of \$186,198,000, or about 46 percent of the total amount sought. The great majority of the applying concerns were small or medium in size.

The Federal Reserve banks approved 2,705 such applications for the total amount of \$179,036,000. Advances outstanding on May 17, 1939, totaled \$15,352,000 and commitments outstanding on that date were \$11,688,000, the largest volumes of \$32,493,000 and \$27,649,000, respectively, being at the end of 1935. The amount of loans repaid, expired, or withdrawn by applicants by May 17, 1939, aggregated \$137,441,000.

Even if allowance is made for the "emergency" character of this type of credit and for the somewhat restrictive provisions of section 13b, the total volume of approved applications and loans has been relatively small. Total loans of all banks in the United States at the end of 1938 aggregated \$21,354,000,000 and investments \$27,575,000,000.

A detailed analysis of the experience of the Federal Reserve Bank of Philadelphia in handling industrial loans from June 30, 1934, to December 31, 1938, shows that only about 26 percent of the 2,497 inquiries resulted in formal applications and of these less than one-third or 191 could be approved. After approval, 64 applications were withdrawn, so that advances were disbursed to 127 borrowers, or 5 percent of those inquiring originally and 19 percent of those making formal applications.

The greatest number of borrowers represented establishments of small and medium size. There were 45 concerns, or about 35 percent of the 127 recipients

of disbursed loans, whose net worth ranged from \$1,000 to \$100,000; 53 concerns, or 42 percent, with net worth from \$100,000 to \$500,000; 29 borrowers, or 23 percent, whose net worth was upward of \$500,000; and in 11 instances net worth exceeded \$1,000,000. Of the 127 borrowers, 103 or 81 percent received loans ranging from less than \$5,000 to \$100,000. The remainder consisted of 19 concerns whose borrowings varied from \$100,000 to \$500,000, and 5 establishments whose borrowings exceeded \$500,000, one application being approved for \$5,000,000, two for \$4,900,000 and two for \$1,900,000.

Despite the care exercised by experienced personnel at the time the loans were made, 7 borrowers have been placed on the "trouble list" and 5 have petitioned reorganization under section 77b of the bankruptcy law. The principal difficulties which forced these borrowers into receivership were inadequate management, highly unfavorable competitive positions, excessive carrying charges, and general price instability. On the other hand, 60 borrowers or about 47 percent of those receiving funds have paid off their loans and are continuing in business.

This analysis shows that, while the record of cost of making and servicing these loans by the Federal Reserve Bank of Philadelphia may be regarded as satisfactory, it is not to be assumed that costs or losses are controllable or predictable. By reason of experienced personnel and adequate facilities already in existence when the law went into effect, expenses have been relatively low and excessive losses have been avoided. It is doubtful whether or not this could have been accomplished if an entirely new agency had been set up.

B. The experience of the Reconstruction Finance Corporation in making and servicing loans to industrial and commercial businesses has been equally enlightening, especially as the legal provisions governing such loans have been considerably broadened

In the 7 years during which the Reconstruction Finance Corporation has been in existence (February 2, 1932, to February 2, 1939), authorizations for loans to business enterprises have numbered 7,371, the amount involved aggregating \$390,816,097, of which the sum of \$160,595,495 has been disbursed. Loans for \$5,000 or less comprised over one-third of the total number, while those for \$50,000 constituted 83 percent.

The volume of credit extended primarily to small and medium-sized business has been limited. On April 30, 1939, the outstanding volume of loans to industrial and commercial business amounted to \$112,531,000. In its Seven-Year Report, the Reconstruction Finance Corporation points out: "Within the past year our Board has authorized approximately two out of every three applications presented. Each application receives the most sympathetic consideration, and when it cannot be approved as submitted, every reasonable effort is made to find a basis upon which a loan can be approved." This statement not only tends to corroborate the belief that the effective demand for credit is limited but it also suggests, as has been the case in extension of credit under section 13b of the Federal Reserve Act, that the applications represent borderline enterprises and that each prospective loan must be very carefully considered even though the character of the credit contemplated is essentially of an emergency nature.

This report observes further: "We shall probably have a substantially larger percentage of losses from industrial loans than from any other class. Forty-six of these (representing loans in the aggregate amount of \$3,009,092) have already been foreclosed and the security reduced to possession. Properties securing three of these loans, which amounted to \$234,905, have been sold at a net loss to the Corporation of \$31,003. Five hundred and forty-three loans to business, aggregating \$21,427,000, are in default and 60, aggregating \$3,588,000, are in process of foreclosure, usually after several extensions and supplemental loans.

The record of the experience of these agencies covering the entire country does not support the belief that there exists a large volume of justifiable but unsatisfied demand for credit by business of small and medium size. The amount of loans outstanding is insignificant—less than 1 percent of the \$21,354,000,000 of all bank loans outstanding. Nor does this experience substantiate the claim that many of the prospective borrowers have a "reasonable and sound basis" for favorable credit consideration.

In 1932 and 1934, when these "emergency" lending agencies and powers were being established, it was generally assumed that the unsatisfied demand for

credit was large. The surveys made at that time by Federal Reserve banks and other organizations indicated that this general belief overrated the prevailing need—as the experience of the lending agencies subsequently demonstrated.

In the survey made in 1932 by the Federal Reserve Bank of Philadelphia, replies were received from 2,800 concerns. In the commercial and industrial groups, 30 percent replied that they were not interested in obtaining credit under prevailing conditions, and of those who were making use of banks, only about one-fourth encountered any difficulty or were refused loans. In nearly all specific lines of business, the greatest difficulty was encountered by concerns with net worth under \$50,000 and with limited or no credit rating, and this difficulty primarily reflected their need for proprietary capital rather than for credit.

In 1934 replies to a telegram questionnaire were received from 469 banks and chambers of commerce. The results in general were the same as in 1932—only a small proportion of respondents believed that there was any significant demand for funds in their communities.

C. The Federal Reserve Bank of Philadelphia in November and December 1938 sent out questionnaires to 1,166 establishments of small and medium size operating in the third Federal Reserve district. More than one-third or 400 individual concerns replied, and the information from 380 was in usable form. The remaining 20 questionnaires were returned unanswered because the firms were in liquidation, out of business, or were branches of corporation with head offices elsewhere.

The analysis of the data so obtained shows that 361 of the 380 replying establishments, or 95 percent, do not desire credit or equity capital under prevailing business conditions. Only 16 concerns, or 4.2 percent of the returns, indicated a need for funds, primarily refunding or equity capital; and 3 respondents, or 0.8 percent, applied to the Reconstruction Finance Corporation for loans but their applications were rejected.

Difficulties encountered by concerns seeking bank credit reflected the depletion of resources occasioned by unsatisfactory operating conditions since 1929. These difficulties are of three types: (a) Weakened financial positions; (b) lack of acceptable collateral; and (c) the long-term or equity nature of funds desired, and reflect primarily the underlying influence of unfavorable competitive positions and inadequate management.

Comments from the great majority of concerns indicate clearly that what individual business establishments need most are orders for their products. They indicate that responsible management will not borrow unless it has a reasonable belief and expectation that money can be used profitably and the loans be retired or repaid at maturity. These comments indicate further that such belief and expectation have been lacking. The tendency has been to increase costs largely through such rigid elements as prices of raw materials, wages, and taxes. These elements have been particularly difficult for small and medium-sized businesses, which frequently are not able to effect economies or adjust their current position to meet these requirements.

D. The information obtained from banks in the third Federal Reserve district through correspondence and personal interviews with bankers in the leading industrial cities by officers of the Federal Reserve Bank of Philadelphia shows the following:

Those small businesses and a few larger ones in need of funds represent primarily establishments whose condition is such as to provide no basis for bank credit. For the most part permanent or fixed investment capital is required.

The caution that dominated banks after their experiences in the twenties has been relaxing somewhat, as evidenced by their willingness to consider other types of credit than the so-called strictly commercial, self-liquidating loans, to wit, small personal loans, loans for the purchase of automobiles and household appliances, term loans, and loans secured by insurance policies. Recognizing the change in the character of the credit needs of business, bankers today are contemplating or making so-called term loans, the purpose of which includes purchasing industrial equipment and acquisition of other fixed assets, revamping of outstanding debt or capital structure, and rehabilitating working capital of businesses.

There apparently prevails among some bankers a feeling that certain phases of former credit practices have been somewhat rigid. There is a recognition of the fact that "short-term commercial loans" were frequently short in form only and in reality often required numerous renewals over a period of several years before complete liquidation. The increased willingness on the part of banks to extend credit on an amortized basis is a natural evolution of this former practice of renewals. Broadened discounting facilities at present favor some relaxation and adjustment of credit terms to existing conditions consistent with a reasonable degree of safety and soundness.

With large resources on hand and under pressure for earnings, banks universally are searching new fields where their idle funds can be safely and profitably employed. For that reason there appear to be few, if any, cases within the scope of grantable bank credit that commercial banks are not willing to consider carefully.

That banks are making installment and term loans to commercial and industrial businesses, predominantly of small or medium size, is indicated by the figures obtained from 27 banks in Philadelphia, Camden, Scranton, and Wilmington as of April 19, 1939. The original or face amount of such loans maturing in from 1 to 3 years and in over 3 years shows the following:

Size of loan	Number	Amount
Less than \$100,000.....	767	\$8, 757, 900
\$100,000 to \$999,999.....	50	12, 814, 400
\$1,000,000 or more.....	2	2, 000, 000
Total.....	819	23, 566, 300

The information further shows that banks are holding large amounts of unemployed funds and that they are eager to put them to work in order to improve earnings positions.

A recent survey of loans of the leading weekly reporting banks in 101 cities, which represent about 70 percent of the deposits of all member banks of the Federal Reserve System, shows that 25 percent of commercial loans made by these banks was of more than 1 year maturity. Such loans, numbering 24,600, aggregated \$1,410,000,000, of which \$420,000,000 maturing in from 1 to 3 years was made to 18,000 borrowers, and \$990,000,000 in loans maturing in 3 years or more to 6,600 borrowers.

SUMMARY

A. The analysis of data summarized here does not indicate that there exists any substantial demand for justifiable bank credit that banks in various communities are unwilling to consider with utmost care.

B. It appears that unsatisfied justifiable demand for bank credit is relatively small, largely because of the lack of business opportunities and continued uncertainties in conditions under which business establishments are operating. For the most part the existing demand reflects desire for refunding of debts or for proprietary capital.

C. The majority of business enterprises apparently do not desire to burden themselves with additional debts under present operating conditions. If weaker or borderline enterprises are sustained by an unrestricted supply of funds, the effect would be to disturb the entire competitive system. It would tend to impair the position of the large number of those concerns which have weathered the economic storm and are in condition to perform their normal business function. This would be tantamount to unfair competition and would be detrimental to business progress.

D. Owing to a superabundance of available funds and to the constant pressure for earnings, banks are not only willing to make loans of all justifiable categories but they are also soliciting directly all types of borrowers who can show a reasonable basis for bank credit.

E. Underlying current discussion there seems to be a failure to distinguish between short-term loans, the repayment of which depends upon the conversion of assets, and longer term or intermediate term credit, the retirement of which is predicated upon earnings. There is also a confusion between the functions of bank credit and those of equity or venture capital.

F. The data summarized herein suggest that the problem of stimulating the demand for credit goes beyond the mechanistic approach directed primarily toward the liberalization of credit standards and practices. The problem is more fundamental and should be considered in conjunction with those influences which are apparently interfering with the profitable use of credit and business recovery. It would seem essential that a comprehensive study of all factors relating to credit and capital requirements should be made before any plan is enacted into law.

Senator WAGNER (chairman of the subcommittee). We will now hear Mr. Smith, president of the Federal Advisory Council, if he will come around to the committee table.

STATEMENT OF WALTER SMITH, PRESIDENT OF THE FEDERAL ADVISORY COUNCIL, PRESIDENT OF THE FIRST NATIONAL BANK, ST. LOUIS, MO.

Mr. SMITH. Mr. Chairman, may I read a statement I have here?

Senator WAGNER. Yes.

Mr. SMITH. I would like to make the following comments in connection with Senator Mead's bill, S. 2343.

The fundamental weakness of the bill, as I see it, lies in confusing the need for risk or equity capital as distinguished from bank credit and if passed will prove disappointing in its results as it is based on a false assumption.

The supporters of the Mead bill take the position, apparently, that small-business men are handicapped by inadequate credit and are denied banking facilities. As far back as 1934 a study was made by Dr. Viner in the Fourth and Seventh Federal Reserve Districts, and since that time investigations have been made by the Small Business Men's Association and the National Industrial Conference Board with the result that the reports do not indicate a shortage of bank credit for small business, but a need in most cases for partnership capital.

There are two additional studies being made at the present time as to the availability of bank credit, one through the Federal Reserve banks, and the other by the S. E. C. through the Junior Chamber of Commerce. It would seem desirable to defer action on the Mead bill pending a study of the results of these Nation-wide investigations.

Granting, for argument's sake, that the bankers have erred to some extent in the extension of credit to small business, there still would be no need for governmental action.

Competition from other lending agencies would correct the situation and provide ample lending facilities for small business, just as it did in developing the finance companies in the past to supply consumer credit. When the need for consumer credit developed and the banker doubted the soundness of that type of credit, special lending agencies quickly developed to supply the demand.

There was no necessity for providing governmental insurance facilities to take care of the legitimate borrowing requirements for consumer credit.

The very fact that at a time when available investment funds have been the greatest in history, and no specialized facilities have been set up to supply the deficiency on the part of small business, is of itself rather convincing proof that the requirements of small business are not for sound credit but rather for risk capital.

There is, on the other hand, ample evidence that risk capital in recent years, due no doubt to higher taxes, labor difficulties, and so forth, has not been responding in its former or customary manner.

Because risk capital has been hesitant in recent years, those seeking such capital clamor for loans to supply the void resulting from their inability to secure equity financing. The cure for this situation does not lie in the Mead bill.

If it is the intent of Congress that the Federal Government should, through the medium of this bill, become a partner in thousands of enterprises, then the utmost consideration should be shown those competitive enterprises which are capably and efficiently managed.

Very little can be gained and probably untold injury done to thousands of solvent, well-run businesses, by unfair competition of inefficient and poorly managed concerns operating for a time with taxpayers' money.

The provision which places the first 10 percent of the loss on the insured banks will not, in my opinion, result in any substantial loans being made under the bill, as banks could not afford to absorb the heavy losses which would be sustained in the extension of loans for equity capital due to the fact that the average net return on bank loans today is less than 1 percent.

The provision prohibiting the insuring of a loan "to any person" of which an officer, director, or security holder owning more than 10 percent of any class of its stock is, or has been within the preceding 12 months a director of the bank making such loan, seems unnecessary and unfair.

Why should a business organization be penalized because one-tenth of its stock is owned by a director of the bank with which it has carried its account.

Furthermore, in small cities and country towns bank directors are chosen almost entirely from the local businessmen, and if the Mead bill is to prove of any assistance to small business, why eliminate what might prove the most fertile field in which the act could serve. I might even say that in practically all large cities all outlying banks would come into the same classification as the small banks in small towns.

The limitation of a service charge fee or commission aggregating during the life of the loan of not more than one-fourth of 1 percent, is grossly inadequate and would not cover the actual expense of handling real-estate papers, checking tax records, safeguarding insurance expirations, and compiling the reports which are required by the R. F. G. In the case of a \$20,000 loan running 10 years, the maximum charge would be \$5 per annum.

Would suggest that in lieu of the right to rediscount insured loans with the Federal Reserve Bank, that the bill should provide that the lending bank, or its assignee, would have the right to borrow on its obligation secured by insured loans up to the amount of the insurance coverage on each loan, as in practice a bank would be unlikely to rediscount a 10-year obligation with any financial agency.

As I have stated before, none of the surveys that have been made indicate that there is a credit shortage for large or small business and I would like to submit to this committee some data with reference to the determined efforts made by the St. Louis bankers in an endeavor to increase loans in their district.

The method pursued includes advertising by radio, bill boards, direct mail campaign, personal solicitation, and newspapers. It is not infrequent to find three or four banks advertising in one edition of the daily paper with such headings as "Wanted: by banks, more borrowers for their loanable funds," "Here the same yardstick measures a \$1,000 or \$100,000 loan," "Banks are not only willing but anxious to make loans," "Wanted: business concerns that can use bank credit." These types of advertising have been appearing in the St. Louis papers for a year.

I will be glad to leave with the committee samples of the newspaper advertising which is used by some of the St. Louis banks.

As an evidence of the results of this advertising and the desire of our banks to make loans, I submit the following record of three banks in St. Louis, viz:

Bank No. 1 made 2,612 loans from January 1 to June 7, 1939, totaling \$23,713,446.63, of which 2,435 were under \$25,000 which aggregated \$9,088,069, or an average of \$3,732 per loan.

Bank No. 2 made 3,088 loans from January 1 to May 31, 1939, totaling \$32,857,531.90, indicating an average of slightly in excess of \$10,000 per loan.

Bank No. 3—a smaller institution—reports a total of 696 loans made from January 1 to June 1, 1939, aggregating \$1,583,000, or an average of \$2,280 per loan. All of these banks have extended term credits running from 1 to 10 years.

It would seem just as intelligent to criticize the bankers for refusing to lend money as to accuse a merchant for refusing to sell goods, as interest to the banker is just as necessary for his existence as profit on the sale of goods by a merchant.

In conclusion, if you will permit, I would like to quote from an article by Gen. Hugh Johnson a few days ago, as follows:

In the first place, the only way a bank can make profits is to lend money—to both big and little customers. It is as much the business and instinct of a banker to lend money and make profits as it is the business and instinct of a hog to root. All the bankers I know are hungry to make loans—and most of them are scouring the woods for them as never before in recent years.

Since I got here, Senator Wagner, I received an excerpt from the report of the St. Louis Federal Reserve Bank, if I may read that into the record.

The Reserve bank states that it is the opinion of bankers, brokers, businessmen and investors that there is a reluctance to provide funds for additional capital or intermediate credit to business enterprises under present conditions, especially for small businesses, when there exists doubt in the mind of most everyone as to the future of business and as to the chances of proper returns on investments. It is also pointed out that many businesses will not accept credit under the present-day business conditions. The Reserve bank states that it feels the intermediate credit needs of business in its district has been over-emphasized, and further, that there always has been and always will be a demand for credit from individuals and concerns who are not entitled to it. The matter of commercial banks providing intermediate credit needs to business is one to be approached with caution.

Senator WAGNER (chairman of the subcommittee). We thank you.

Mr. SMITH. I would like, if I may, to pass out some samples of the advertising matter so that the members of the subcommittee may see them. I think there is a feeling abroad that banks are not striving

very hard to place their funds, and this will at least be in part an answer.

Senator WAGNER (chairman of the subcommittee). Senator Mead, you may feel at liberty to ask any questions.

Senator MEAD. All right.

Senator HUGHES. Mr. Smith, in your territory do banks make amortized loans?

Mr. SMITH. Yes, sir.

Senator HUGHES. For 10 years?

Mr. SMITH. A few for 10 years, but mostly our limit has been 5 years.

Senator HUGHES. There is some complaint as to that. I have heard complaint that there is a lack of amortized loans. If a man wants \$10,000 and he is not able to pay it at the end of the year, why, if he had a longer period, something like 10 years, he could out of his earnings pay it, that such an arrangement would ease the situation.

Mr. SMITH. Senator, we have had no requests for amounts as small as \$10,000 to be amortized over a 10-year period. I think I would have heard of them if other banks had received such requests.

Senator HUGHES. I was speaking of \$10,000 as being the amount that small-business men talk about.

Mr. SMITH. I spent most of my life on the credit side of banking, and I just wonder at the wisdom of a man who can take a small concern and know how its credit standing will prevail throughout a 10-year period. The percentage of those that fail over a 10-year period is astounding.

Senator WAGNER. Have you a record, Mr. Smith, of the number of rejections of applicants?

Mr. SMITH. No; I have not, Senator. We started that as of June 1. I think we should have had it.

Senator WAGNER. Can you approximate it at all from your own experience?

Mr. SMITH. Very, very slight in recent years. I think Will Rogers said at the height of the depression that even the fellow that never paid his bills had quit buying.

Senator CLARK of Idaho. This advertisement advertises long-term loans maturing serially, among others. That is what you had in mind in answer to Senator Hughes' questions?

Mr. SMITH. Yes; we have done everything we could to get all kinds of loans. That is not 10 percent of the data that was furnished me.

Senator WAGNER. Are there any further questions to be asked of Mr. Smith? [No response.]

Thank you very much, Mr. Smith.

Mr. SMITH. I thank the committee for the courtesy they have extended to us bankers.

(The witness withdrew from the committee table.)

Senator WAGNER (chairman of the subcommittee). Is Mr. Needham here?

Mr. NEEDHAM. Yes; Mr. Chairman.

Senator WAGNER. Is your witness prepared to go on on Thursday?

Mr. NEEDHAM. Yes, sir.

Senator WAGNER. How many have you for Thursday?

Mr. WIGGINS. We will have probably five or six.

Senator WAGNER. Do not have too many. If there is a witness here now who is from out of town and to whom it would be an inconvenience to stay over until Thursday, we can hear him now. We have some time left.

Mr. WIGGINS. Senator Wagner, I think we would prefer to resume on Thursday morning.

Senator WAGNER. All right.

Senator MEAD. Will there be an opportunity a little later to hear representatives of what might be termed "little-business enterprises?"

Senator WAGNER. Oh, yes.

Senator MEAD. It seems to me it is important, in view of the fact that the Monopoly Committee and the Securities and Exchange Commission in a sort of Nation-wide study have revealed the fact that there is more demand for loans of this character, coupled with the fact that the bankers say there is little or no demand, that the committee find out by contacting the representatives of the business enterprises embraced within the scope of the bill.

Senator WAGNER. There will be ample opportunity for that. I am sure this committee would not close the hearings without giving everybody a chance to be heard.

Senator MEAD. Then at the proper time, and according to the convenience of the committee, they will be heard?

Senator WAGNER. Yes; we will take a recess until next Thursday at 10:30 a. m.

(Whereupon, at 4:25 p. m., a recess was taken until Thursday, June 15, 1939, at 10:30 a. m.)

6/2/39

W. E. E. E.

STATEMENT OF HONORABLE ERNEST G. DRAPER

RE: S. 2343

In testifying on this subject, I wish to make it clear that what I shall say represents only my own personal views and not necessarily the views of the Board of Governors of the Federal Reserve System.

This subject of loans to small business has been such a controversial one that there is danger either of (1) no satisfactory legislation being enacted or (2) such elaborate machinery being set up as to cause the Government an inordinate amount of expense in order to relieve a situation that might have been cured by simpler and more economical means.

Since June 1934 the Reconstruction Finance Corporation and the Federal Reserve banks have had authority to make loans to business and industry subject to certain limitations; and the authority of the Reconstruction Finance Corporation in this respect was broadened by the Act of April 13, 1938. Under the present law, the authority of the Reconstruction Finance Corporation to make such loans will expire on June 30, 1941; but there is no such time limitation on the authority of the Federal Reserve banks to make loans to business and industry. However, the Federal Reserve banks are authorized to make such loans only with maturities of not exceeding five years and only in order to provide "working capital" to businesses that are "established". It is obvious that these restrictions prevent the granting of credit in many legitimate cases where it might be helpful to small business and to the community at large.

Many persons with knowledge of the general problem genuinely feel that the existing avenues for credit to small industry are insufficient. They insist that there is a legitimate need for credit on the part of small but sound concerns and that this need is not at present being met by any agency, either public or private.

The results of certain surveys which have been made on this subject purport to show that there is no need for additional credit facilities for small businesses. I do not doubt that such surveys have been made in the utmost good faith; but the results are not convincing to me, because the conclusions are based very largely upon the fact that only a small percentage of persons to whom questionnaires were sent replied to them. There are many reasons other than the lack of need for additional facilities which may account for the failure of many businesses to reply to such questionnaires.

Why not get to the bottom of this problem, once and for all, by devising legislation which is simple in character, inexpensive in operation and cooperative in its approach? In this way we could meet the present difficulty squarely and without reliance upon an entirely new set-up of elaborate and perhaps unwieldy machinery. Then, if it should develop after the passage of such simplified legislation that the need is not as great as anticipated, no great harm would be done and no great expense incurred. If, however, the need should prove to be greater than anticipated, the flexible machinery of this new plan could easily take care of any increase in demand, regardless of its volume.

There is much to be said in favor of the approach to this problem proposed in the Mead bill, since it avoids the creation of an additional system of banks, which would be expensive and slow to get into operation, and seeks instead to encourage the use of part of the enormous amount of credit now lying idle in the banks by providing insurance through the Reconstruction Finance Corporation, which is already in existence and has accumulated much experience in this field.

I believe, however, that the bill could well be improved and liberalized in some respects. I have here a memorandum containing suggestions for the improvement of certain technical features of the bill which I shall ask leave to have inserted in the record at the conclusion of my testimony; but I wish at this point to mention one feature of the bill which I think especially needs liberalization.

Under the bill as now drafted (page 2, line 8) the Reconstruction Finance Corporation could insure a lender only against any loss in excess of 10 per cent of the amount of the loan. In other words, the insured lender would have to absorb all loss up to 10 per cent of the amount of the loan and the insurance would only cover any loss that might occur in excess of that amount. Insurance so limited might not afford sufficient protection to encourage banks to make loans on a more liberal basis than they would without insurance and thus the bill might fail to accomplish its chief purpose. I believe that the principle of retaining a local interest in each loan could be preserved and the beneficial effects of the legislation could be greatly increased if the bill were amended so that the insured bank and the Reconstruction

Finance Corporation would share any loss that might occur on some pro rata basis to be specified in the law.

I also hope that your Committee will consider the advisability of adding to this bill a separate title providing for the utilization of the existing machinery of the Federal Reserve System in extending additional credit facilities to small businesses on a much more liberal and flexible basis than the Federal Reserve banks are now permitted to extend under the limitations prescribed in section 13b of the Federal Reserve Act. Such a plan deserves careful consideration, because the existence of the 12 Federal Reserve banks and 24 branches located strategically throughout the United States and already staffed with trained and experienced personnel offers an excellent opportunity to decentralize the actual administration of this business and have it handled locally by persons familiar with the problems and already in close touch with the banks of the regions in which the applications arise.

At the same time the assets and liabilities resulting from such operations could be segregated in a separate corporation organized as an integral part of the Federal Reserve System, utilizing the existing personnel and other facilities of the Federal Reserve banks and acting under the general direction of the Board of Governors, which could be charged with the duty of seeing that the corporation functions in such a manner as to meet whatever legitimate need there is for additional credit facilities for small businesses, either directly or through

cooperation with existing banks and other financing institutions.

I wish to make it clear that this is proposed as an addition to the Mead Bill and not as a substitute for it. The provision of such additional facilities on a regional basis could not in any way impair the effectiveness of the facilities provided for in the Mead Bill but would supplement those facilities in a manner which might prove to be very helpful.

SUGGESTIONS FOR IMPROVEMENT OF
MEAD BILL, S. 2343

(Presented by Hon. Ernest G. Draper)

The provisions in the bill regarding the distribution of losses (p. 2, line 8) differ from those which are contained in other insurance plans set up by Congress. The bill, as now drafted, provides that the Reconstruction Finance Corporation may insure against the whole or any part of a loss which an insured bank may sustain in excess of 10 per cent of the principal amount of the loan. Thus, for example, if a loss of \$10,000 were suffered on an insured loan of \$100,000, the insured bank would have to bear the entire loss and the Reconstruction Finance Corporation none. Since a bank would derive no benefit from the insurance until after it had suffered a loss equal to 10 per cent of the loan, a question arises whether the bill in its present form would give sufficient encouragement to banks to make such loans on a more liberal basis than they would without such insurance. It is believed that the benefits afforded by the bill might be more generally utilized if this provision were changed so that the insured bank and the Reconstruction Finance Corporation would share in such loss as might occur on some pro rata basis to be specified in the law.

It is also believed that more loans would be made and increased benefits derived from the legislation if more flexibility were provided in the bill with respect to rates of interest and the insurance premiums. The restrictions in the present draft in these respects may result in limiting the usefulness of the additional facilities provided by the bill.

The fifth limitation in section 3(b) of the bill (page 3, line 22) would forbid the making of such loans to a borrower of which an officer, director or security holder owning more than 10 per cent of any class of the borrower's stock is, or has been within the preceding 12 months, a director of the bank making such loan. It is doubtful whether this restriction would serve any useful purpose and it may prevent the making of sound and desirable loans. It is believed, therefore, that the bill should be liberalized by eliminating this restriction.

The bill would be improved if the provisions of section 5 regarding the rediscount and purchase and sale by Federal Reserve banks of obligations evidencing loans insured under the bill were changed to a provision authorizing the Federal Reserve banks, subject to regulations prescribed by the Board of Governors of the

Federal Reserve System, to make advances to member and nonmember banks for periods not exceeding six months at a time on their promissory notes secured by such obligations, at rates to be established from time to time by the Federal Reserve banks subject to the review and determination of the Board of Governors. From the standpoint of practical operation, experience has shown that it is more convenient and less expensive both to the Federal Reserve banks and to the member banks for the Federal Reserve banks to make advances to member banks on their promissory notes secured by the pledge of assets than it is to rediscount such assets. Rediscounts, furthermore, are ordinarily held until maturity so that the discounting bank has to pay the discount rate from the date of discount until maturity, whereas advances can be made for limited periods and renewed from time to time as the circumstances require, so that the borrowing bank pays interest only for the period during which it needs the credit.

If it is deemed advisable to provide a market in which such obligations can be sold, it is suggested that consideration be given to provision for the organization of a corporation to purchase such obligations and to issue and sell debentures against them, in a manner similar to that in which the RFC Mortgage Company now operates in the field of insured mortgages.

It is not clear that the insurance provided in the bill would inure to the benefit of an institution which rediscounts or makes an advance against such a loan, since section 4(b) provides that the insurance shall inure only to the benefit of any "assignee" or any "purchaser". To eliminate any doubt on this point, it is suggested that the remainder of the sentence following the words "the benefit of" on page 5, line 10, be changed to read "any person to whom such a loan shall have been assigned or pledged, or by whom such a loan shall have been purchased or rediscounted."