Supplementary Material

to

Joint Answers Prepared Under the Direction of a Special Committee

Of Federal Reserve Bank Presidents

submitted by

Hugh Leach, President, Federal Reserve Bank of Richmond

to the

Subcommittee on General Credit Control and Debt Management

of the

Joint Committee on the Economic Report

82nd Congress

November 1951

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FEDERAL RESERVE BANK OF RICHMOND

RICHMOND 13, VIRGINIA

November 13, 1951

Honorable Wright Patman, Chairman,
Subcommittee on General Credit
Control and Debt Management,
Joint Committee on the Economic Report,
82nd Congress,
Congress of the United States,
Washington, D. C.

My dear Mr. Patman:

With your letter to me of October 12, 1951, you enclosed a list of questions on general credit control and debt management and asked for answers by November 15.

In view of the comprehensive nature of many of the questions and the limited time available, it was thought advisable by the Presidents of the Federal Reserve Banks to have joint answers prepared under the direction of a special committee of Presidents. This was in accord with the note at the top of the list of questions.

I am in substantial agreement with the answers prepared by the special committee and adopt them as my answers with the exceptions and comments noted below.

With respect to question 6, I add a supplement to describe a usage that is peculiar to the Fifth Federal Reserve District.

I submit brief comments on certain aspects of the joint answers to questions 14, 20, 30, and 31.

Inasmuch as questions 34, 35, and 36 apply to district rather than country-wide conditions, I make complete answers to each of them rather than adopt the material prepared under the direction of the special committee as partial answers to questions 35 and 36.

It is a pleasure to submit herewith two booklets - one containing the joint answers prepared under the direction of a special committee of Federal Reserve Bank Presidents and the other the supplementary material referred to above.

Sincerely yours,

Hugh Leach,
President.

Question 6

State the qualifications required for election as class A and class B directors of the Federal Reserve banks, and the method of electing such directors. Include in your description both qualifications and procedures prescribed by statute and those established by customary usage, distinguishing between them when necessary.

Supplement to Joint Answer

There is no distinction between the qualifications required for election as class A and class B directors prescribed by statute and those established by customary usage in the Fifth Federal Reserve District. However, a procedure peculiar to the district is followed in the nomination and election of such directors by the three general groups of member banks prescribed by statute.

The Fifth Federal Reserve District is composed of the States of Maryland, Virginia, North Carolina, and South Carolina, all of West Virginia except six counties in the northern panhandle, and the District of Columbia. Since the member banks in the district had to elect six directors prior to the opening of the bank, they arranged to hold a conference in Richmond of representative bankers from these six geographical divisions on May 18, 1914, approximately six months before the bank was opened. Representatives of 210 member banks were present at the conference, at which it was decided to appoint a committee of eighteen (three from each of the six geographical divisions) to consider the question of nominations and the adoption of some method to insure a satisfactory distribution of representation among the six divisions. This committee recommended that one director be elected from each of the six geographical divisions and that the nominees of Group 1 banks be a class A director from Maryland and a class B director from Virginia; of Group 2 banks, a class A director from North Carolina and a class B director from South Carolina; and of Group 3 banks, a class A director from West Virginia and a class B director from the District of Columbia.

The recommendations of the committee were unanimously adopted by the conference and it was ordered that the action of the conference be formally reported to all member banks in the district. The agreement thus arrived at voluntarily by member banks of the district before the Federal Reserve Bank was opened has been adhered to continuously from the beginning.

Question 14

Describe the mechanism by which a general tightening or easing of credit, and the changes in interest rates which may result, is expected to counteract inflation or deflation. Discuss the impact on borrowers and lenders in both the short-term and long-term credit markets and on spending and savings. Indicate the effect on each of the broad categories of spending entering into gross national product. What are the (actual or potential) capital losses or gains that would be brought about by changes in interest rates? To what extent is the effectiveness of a program of credit restraint affected by or dependent upon expectations with respect to subsequent changes in interest rates? Distinguish in your discussion between small changes in rates and large changes in rates.

Comment on Joint Answer

As indicated in the joint answer, open market operations can be the most flexible and effective instrument of general credit control for use in tightening or easing bank credit. However, it should not be overlooked that the other quantitative credit control instruments - reserve requirements and discount rates - are an integral part of System policy. Even though changes in reserve requirements are admittedly a clumsy tool to be used sparingly and the effect of discount rate changes is now largely psychological, these instruments can be of considerable value under certain circumstances.

It is true, of course, that an increase in requirements at a time when member banks have few loans and heavy investments in Government securities selling above cost will have little restraining effect on most banks beyond reducing potential expansion on a given amount of excess reserves, because they can sell securities (at a profit) to the Federal Reserve System. However, the situation would be quite different if the volume of outstanding loans was so large that many member banks would find it difficult or impossible to adjust their reserve positions to additional requirements by offsetting sales of Government securities. Under such conditions an increase in reserve requirements would undoubtedly be restrictive. The restrictive effect would be increased at times when banks could sell government securities only at a loss.

Granting the current effect of discount rate changes as largely "psychological", it has been clearly demonstrated in the postwar period that discount rate increases do have an immediate effect (apart from open market operations) on the credit climate and short-term money rates.

Question 20

What do you believe to be the role of bank examination and supervision in furthering the objectives of the Employment Act?

Comment on Joint Answer

The first of the three objectives of bank supervision given on page 76 of the joint answer - "To see that the public is provided with adequate banking services" - is interpreted as meaning that supervisory authorities give considerable weight to adequacy and availability of banking services when considering applications for permission to open new banks or to establish additional branches of existing banks. This should not be considered as implying that supervisory authorities do or should look upon themselves as "prime movers" in the organization of new banks or branches.

Question 30

Discuss the advantages and disadvantages of requiring additional reserves which might be held in whole or in part in the form of Government securities. Illustrate with a specific plan or plans.

Question 31

Discuss the advantages and disadvantages of requiring during the national defense emergency a supplementary reserve to be maintained against increases in either loans and investments or deposits. Illustrate with a specific plan or plans.

Comment on Joint Answers

While the inequities and administrative and other difficulties inherent in these proposals are fully recognized, it is conceivable that a situation might arise in which consideration of individual equities and administrative feasibility should be subordinated to the immediate national interest. If a situation developed in which existing general and selective controls proved inadequate, it would be necessary to explore further these and other plans tailored to the need of the specific emergency, despite the important shortcomings of such proposals as have been suggested. Just as we feel that additional selective credit controls are undesirable but might have to be considered under some circumstances, we would not rule out the possible need for exploring other types of reserve requirements.

Question 34

Will you please submit a memorandum discussing the adequacy of banking facilities in your District? For this purpose, take as your standard of adequacy the ideal of bringing banking facilities within convenient reach of all persons having need of them, and, so far as practicable, giving all persons the opportunity of choosing between two or more competing banks. Distinguish between deposit facilities and loan facilities.

The Fifth Federal Reserve District, comprised of Maryland, District of Columbia, Virginia, West Virginia (excluding the six-county panhandle), and North and South Carolina, has 7.9 per cent of the banks and branches in the United States, 5 per cent of the land area of the continental United States, 9.6 per cent of the population, and 7.7 per cent of the nation's income payments to individuals (1950). The average density of population per square mile in the Fifth District is 96.4 as compared to 50.6 for the nation. The relatively high figure for the District is in large part a consequence of the large population concentrations in three metropolitan areas: Baltimore, the District of Columbia, and Hampton Roads. These three areas account for almost one-fourth of the total population of the Fifth District.

Almost one-fourth of the 319 counties in the District, arbitrarily counting the District of Columbia as a county, have one banking office for each 5,000 persons or less. This is a low ratio when compared with 13,567 for the city of Baltimore, 9,596 for the city of Richmond, and 8,378 for the city of Charlotte. The national average is, incidentally, just over 7,000.

Four out of five counties in the Fifth District have two or more banks and branches. In 62 per cent of the counties there is one banking office for each 10,000 population or less. Thirty-one per cent of the counties have a ratio of population to number of banks and branches between 10,000 and 20,000, the majority of which are found in North and South Carolina. Only 16 counties in the entire District have only one banking office per 20,000 population or more and only five counties out of the total of 319 have no banks.

It would appear that, as indicated on the accompanying maps, banking facilities are adequately distributed throughout most of the District to meet the needs of individuals and business enterprises. Similarly, there is throughout most of the five-state District reasonable opportunity for depositors and borrowers to choose between two or more banks.

In some instances misleading impressions may arise from the presentation of data by county. Frequently people living in counties with high ratios of population to banking offices have access to banking facilities across county lines. This is particularly true when we consider contiguous counties comprising an area of homogeneous economic characteristics.

Less than 2 per cent of the counties embraced in the Fifth Federal Reserve District are "no bank" counties--New Kent, Charles City, King and Queen, and Cumberland counties in Virginia, and Camden County, North Carolina. Despite the absence of within-county banking facilities, analysis of these counties indicates that competing facilities are reasonably convenient, (for the purpose of this memorandum, facilities within 20 miles are regarded as reasonably convenient) across county lines to depositors and borrowers throughout each of the five counties. Supporting this conclusion are the following characteristics common to all five counties: (1) sparse population; (2) no urban areas; (3) virtually no manufacturing activity; (4) low per capita income; (5) "shoe-string" shape (maximum width 12 miles); and (6) reasonable proximity to competing banking facilities in adjoining counties.

There are 54 one-bank counties in the Fifth District, but only 13 of them do not have competing banking facilities within reasonably convenient reach of all parts of the counties. These counties are Floyd in Virginia; Calhoun, Morgan, Pendleton and Webster in West Virginia; Alleghany, Currituck, Dare, Graham, Pender, Tyrrell, and Washington in North Carolina; and McCormick in South Carolina.

In every one of the 13 counties there is a low density of population per square mile (average--26.2; range 12.7-39.2), and every one of the counties has a relatively low ratio of population to banking offices (average 9,997; range 5,048-18,423). In the majority of these cases it is extremely doubtful that the sparse population and slender economic resources could support the additional banking facilities necessary to put all portions of the counties within convenient reach of more than one banking office. Only relatively small areas within each county are without reasonably convenient competing banking facilities, and in two cases the deficiency is corrected by crossing state lines. Manufacturing activity is nil or insignificant in every county; the average number of Census-classified manufacturing establishments for the group is 12, with a range from 2 to 25.

There are in the Fifth District only 16 counties (5 per cent of the total) with ratios of population to banking offices of 20,000 or over. In most of these cases, however, banking facilities appear reasonably adequate and individuals and businesses do have access to competing banks. The basic factors considered in arriving at this conclusion were availability of banking facilities in adjacent counties, economic environment, urban concentrations, and supplementary bank-type services such as those provided by large coal companies.

Three of these counties--Buchanan in Virginia, Logan in West Virginia, and Henderson in North Carolina--do not appear to provide individuals and businesses with a choice between two or more competing banks. Based on population alone, Logan County in West Virginia, with one bank and a population of 77,000, does not appear to have adequate banking facilities. Yet, rugged topography, scattered population, and coal mining emphasis, with company stores and credit, seem to give a reasonably common-sense answer to the possible query as to why there are no more banks.

Note on Deposit--Lending Facilities

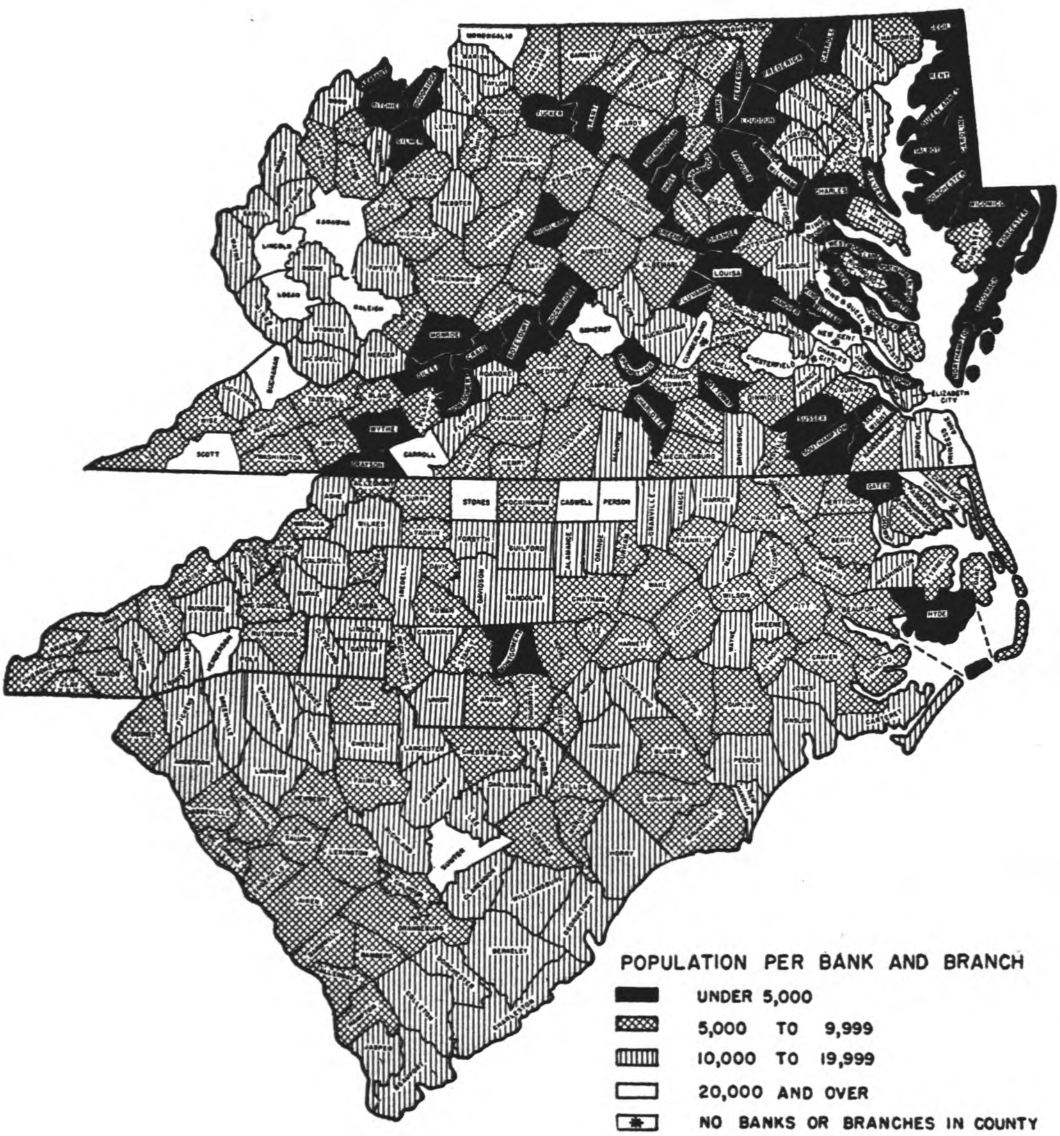
The appended map showing location of Fifth District banks includes 23 depositories in South Carolina. These depositories accept demand deposits, but may only make loans to the extent of their surplus or as brokers for individual depositors.

Also included are all tellers' windows licensed as branches. These may or may not make loans though all accept deposits. As a general rule, they also accept payment on loans and receive credit applications for processing at the head office, so that in effect loan facilities are available at many of these tellers' windows. To our knowledge, there is only one branch in the District which handles loans but does not accept deposits; this branch is included on the map.

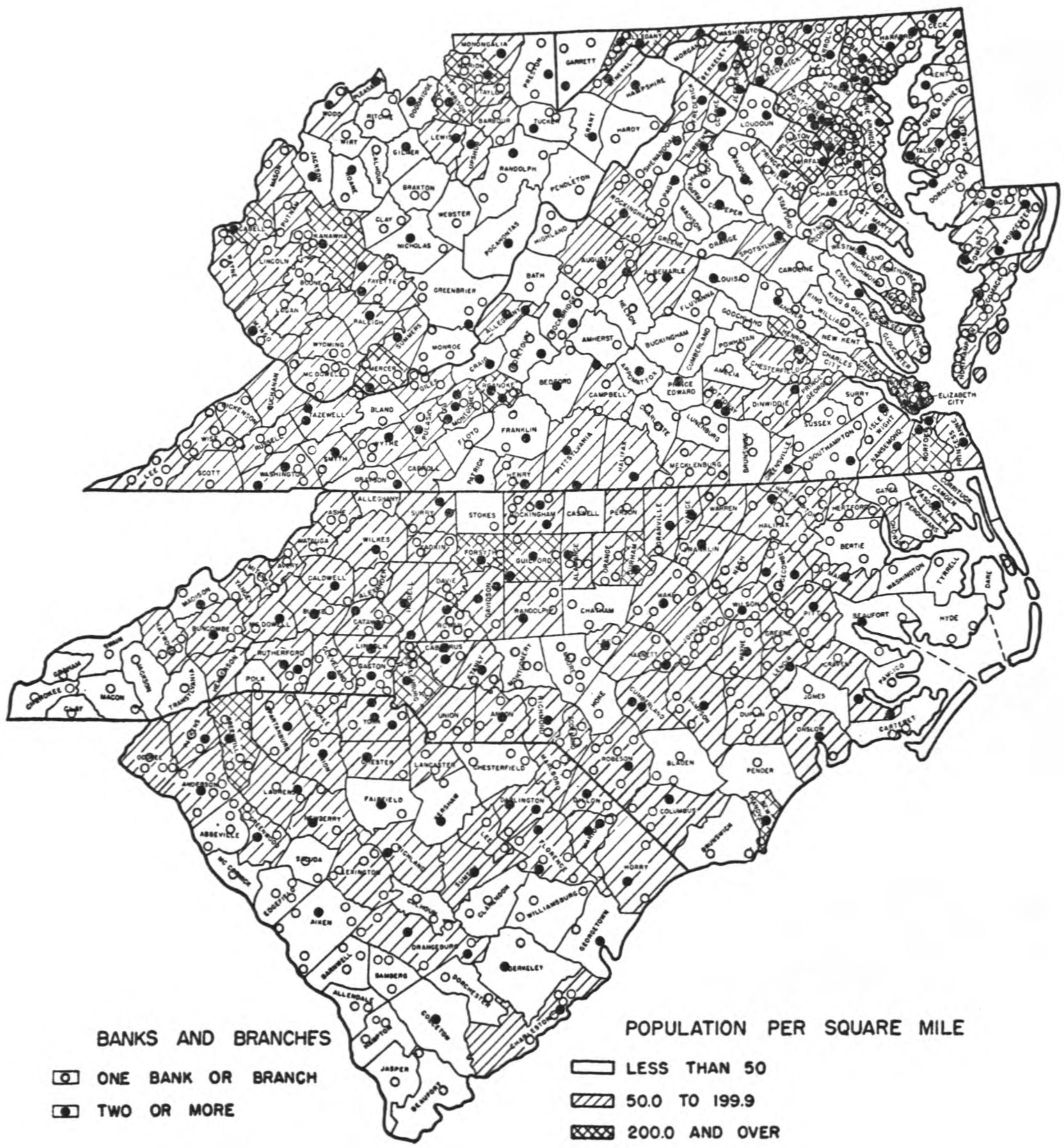
Tellers' windows not licensed as branches and deposit facilities at military installations (unless licensed as branches) are not included. Data indicating the number of such facilities and tellers' windows are not available.

FIFTH FEDERAL RESERVE DISTRICT

RATIO OF POPULATION TO BANKS AND BRANCHES



THE FIFTH FEDERAL RESERVE DISTRICT



Question 35

> On the basis of information available about your district, discuss the changes which have occurred during the last 25 years in the ease or difficulty with which small-business men have been able to raise capital or to borrow. What in your opinion are the reasons for such changes as you find to have occurred? Do you believe that a more liberal supply of capital and credit to small business would contribute to the diffusion of economic power and to the dynamic character of the economy? What steps could be taken to bring about a more liberal supply of capital and credit to small business? Do you believe that any of these steps would be desirable? Distinguish between the longer-term aspects of the problem and those of particular importance today during the current national defense emergency.

In considering the question of changes during the last 25 years in the capital or credit position of small business in the Fifth Federal Reserve District, it should be noted that adequate information is not available to provide a categorical answer. However, in general terms, (a) short- and long-term credit appear to be more readily available due principally to the leadership of commercial banks in developing new lending practices and techniques, but in part reflecting improvements in small-business accounting, inventory, and other operating policies which have improved their credit position; and (b) equity capital may be less readily accessible to small businesses, possibly because of changes in the tax structure which have adversely affected individual venture capital and retained earnings as sources of funds.

With more specific reference to the Fifth District, the following changes relating to the ease or difficulty with which small-business men are able to raise capital or to borrow have occurred:

1. There has been an absolute and relative growth in the financial resources of this area, reflected in such basic factors as bank reserves and life insurance company assets.
2. Banks and other financial institutions in this area have tended increasingly to adopt new and more liberal lending techniques which in turn adapt these resources more successfully to the credit needs of small business.
3. The Federal Government has in some instances supplemented existing facilities for longer-term credit to small business in this area through credit guarantees and direct loans by the Federal Reserve Banks and the Reconstruction Finance Corporation and other governmental lending agencies.
4. Community industrial development corporations have emerged in scattered areas throughout the District, though their activity has to date been limited.

Commercial bank resources constitute one of the major sources of short-term working capital funds and, increasingly, of intermediate-term capital funds of small business. In this connection, bank reserves are a significant measure of the credit potential of any given region since regionally, as well as nationally, bank reserves control the expansion of earning assets by the commercial banking system. Data on bank reserves reveal an absolute and relative growth in the Fifth Federal Reserve District during the past 25 years.

Fifth District Member Bank Reserves as Per Cent of U. S.
Selected Dates, 1925-1951

	Amount (\$ million)	Per Cent of U. S.
End of year 1925	68.0	3.07
1929	64.7	2.75
1932	52.0	2.07
1939	283.0	2.43
1945	727.2	4.57
1950	695.0	4.05
March 28 1951	748.0	3.93
June 30 1951	811.3	4.26

Similarly, life insurance companies in this area have experienced a sharp growth in assets over the past 25 years; a recent study on the Economic Resources and Policies of the South by Calvin B. Hoover and B. U. Ratchford reports:

> Although southern companies are relatively quite small, they had a considerably greater growth between 1929 and 1946 than did nonsouthern companies. Southern companies increased their admitted assets by 308 per cent against 172 per cent for nonsouthern companies; for insurance in force the figures were 153 per cent and 57 per cent; and for premium income, southern companies were ahead by 247 per cent to 57 per cent.

In the postwar period, commercial banks in the Fifth District have been actively engaged in using their expanded financial resources to meet the short- and intermediate-term credit needs of small business. This is reflected in the postwar growth in Fifth District bank loans (both absolutely and relatively) and, more particularly, in the so-called "business loans," including term loans. It is generally accepted that smaller business concerns account for a substantial proportion of such loans in this District.

From June 30, 1945, to June 30, 1951, total loans of all active banks in the District almost tripled and rose from 3.9 per cent to 4.7 per cent of the U. S. total. "Business loans" (commercial and industrial) of District member banks in this same period expanded even faster; on June 30, 1945, they accounted for 20 per cent of the $1.1 billion total loans of all active banks in the District; by June 30, 1951, they accounted for 25 per cent of total loans of $3.0 billion. Although comparative data are not available, a special survey of business loans of Fifth District member banks as of November 20, 1946, revealed that more than 85 per cent of the business borrowers on that date had total assets of less than $250,000 and accounted for almost 45 per cent of the total commercial and industrial loans outstanding on that date. (See attached Table 1.) This same survey revealed that nearly 11,000 loans, or 26 per cent of the total, were outstanding to businesses formed since 1942. These loans were made principally to unincorporated businesses with assets of less than $250,000 and amounted to $65 million, or 13 per cent of the total business loans. (See attached Table 2.)

This recent absolute and relative growth in the extension of business credit (and, as indicated, mainly small-business credit) reflects the increased effort of financial institutions in this area to adapt their resources to the needs of small business. Developments in banks' lending practices in recent years, including the increased use of term loans, field warehouse loans, loans secured by accounts receivable or chattel mortgages, and consumer installment loans, all appear to represent a better adaptation of short- and intermediate-term credit facilities to the needs of small business. Furthermore, increased availability of accounts receivable and consumer installment financing has enabled the small-business man to shift the financing of his customers to the banks and, therefore, to utilize more fully his own capital and credit resources.

Evidence of these developments in the Fifth District may be found in the previously noted survey (November 20, 1946) of Fifth District member bank loans which revealed that term loans (defined as loans of more than one-year maturity) amounted to more than 20 per cent of total commercial and industrial loans outstanding on that date. Loans of longer than five-year maturity constituted nearly 10 per cent of total commercial and industrial loans outstanding on that date. (See attached Table 3.)

Additional evidence as to the efforts being made by financing institutions in this area to develop and utilize a wide range of different financing arrangements adapted to the special needs of prospective business borrowers may be found in the results of last year's poll of Virginia banks by the Advisory Council on the Virginia Economy. In response to the question, "Has your bank ever handled business loans of the following types?", answers indicated a very high proportion of banks making term loans and actually utilizing a large number of different financing arrangements as follows.

Types of Financing Offered Virginia Business by Virginia Banks

Has your bank ever handled business loans of the following types?	Per cent of total banks reporting		
	Yes	No	No answer
a. Assignment of accounts receivable?	42	57	1
b. Pledge of notes receivable?	70	29	1
c. Public warehouse receipts?	37	61	2
d. Field warehouse receipts?	17	81	2
e. Floor plan or trust receipts?	41	58	1
f. Factor's liens?	5	91	4
g. Unsecured term loans under special loan agreements?	50	48	2
h. Term loans against plant liens or other security?	48	50	2
i. Liens on machinery, motor vehicles, or other equipment?	99	1	0
j. Assignment of contracts?	55	44	1
k. Assignment of property leases?	39	60	1
l. Assignment of life insurance?	96	3	1
m. Monthly or other regular installment payment loans?	98	1	1
n. Construction advances on individual or group housing projects?	70	30	0
o. Subordination of existing debts owing to principals or others?	20	77	3
p. Assignment of Government contracts under Assignment of Claims Act of 1940?	17	81	2
q. Participations with R.F.C.?	37	62	1
r. Participations with Federal Reserve Bank?	8	88	4
s. Loans with final maturities as long as:			
Two years?	80	9	11
Five years?	71	18	11
Ten years?	65	28	7

On balance, it appears that commercial banks in this area, as elsewhere, have taken the initiative in developing different forms of lending which have enabled small-business men to finance over longer periods necessary purchases of facilities, equipment, and machinery, and to obtain credit on the basis of assets formerly considered unacceptable as collateral. These lending activities have been supplemented by the direct lending and guaranteeing activities of the Federal Government and the Federal Reserve Banks. The record of 13b loans in this District indicates that in large part these loans and commitments have been used to finance small, rather than large, business. Likewise, a large proportion of V-loans currently being made may be considered as relatively "small business." (See attached Table 4.)

For the most part, then, the credit needs of small business are being handled effectively by existing financial institutions and agencies. Attempting to expand this over-all supply of credit would be particularly inappropriate under the current emergency; the expanding business credit is in fact one of the major factors contributing to underlying inflationary pressures at the present time. The Federal Reserve Banks and commercial banks working together on the Voluntary Credit Restraint Program are trying to curb extensions of business credit, especially to new businesses not contributing commensurately to the defense effort.

The equity capital position of small business is not as clear-cut. Claims of capital shortages undoubtedly have exaggerated the role of "capital" in the success or failure of new business. The management factor is probably most important, and inability to obtain capital or use it effectively may simply be a reflection on management. From the demand-for-funds side, another factor which may superficially indicate a shortage of capital is the fact that small-business men traditionally do not like to give up the control necessarily incident to obtaining additional capital.

It may be that existing sources of funds do not meet all of the demands of deserving enterprisers. But, again, where shortages of capital actually do exist, our present system of taxation may be an important deterrent to availability of funds. Significantly, under present personal income tax rates, net yields do not provide sufficient incentive for risk investment by those individuals who, in terms of income, are normally best able to assume such risks. Also, corporate tax laws which do not distinguish sufficiently between small newly-established enterprises and large established concerns may reduce the possible use of retained earnings, which in the past has been one of the major sources of funds for growing enterprises.

Within the last 25 years, a number of community industrial development corporations have been formed in the Fifth District for the purposes of raising money to build new plants to be leased to individual concerns desiring to locate in the area, providing space in older plants, making loans, providing capital, and making grants to encourage a business to erect a plant in the vicinity. One of the oldest and most frequently cited examples of the successful community development corporation is the Industrial Corporation of Baltimore City, originally organized in 1915 to facilitate the making of investigations and appraisals of applicant enterprises, the maintenance of engineering and related facilities for counseling, and arranging financing from outside sources. Community industrial financing plans of various types have been adopted by a number of other localities in this District, but the aggregate amount of capital provided to small business to date has not been significant.

Recognizing that to the extent additional capital can be made available to meritorious small business, this would in turn contribute to the already dynamic character of the economy; nevertheless, we do not believe that the establishment of additional governmental agencies on a national level to provide capital or loan guarantees for small business is either necessary or desirable. It is our view that such shortages of capital as may exist are primarily local problems and can best be dealt with locally rather than nationally. Local individuals and institutions are better acquainted with the persons and problems involved and are in a better position to consider the merits of these individual cases. Across-the-board financial aid by Government subsidy could lead to uneconomic development of new businesses with consequent damage to sound enterprises and to normal competition which is the most dynamic force in our economy.

To whatever extent there can be shown a real need for additional facilities to supply capital to promising enterprises, this need should be met, first of all, by basic changes in our tax structure--changes designed to reduce or eliminate obstacles to private financing. Revision of tax laws to encourage individual risk investment would go far towards solving any problem of capital shortage. In addition, further preferential treatment to small and newly-established enterprises could be considered. If further need should then be demonstrated, assistance by public and semi-public institutions to privately-managed local or regional institutions organized to seek out sound opportunities for the employment of capital in small enterprises would be far preferable to direct Government financing.

Table 1

Commercial and Industrial Loans by Size of Borrower
Member Banks, Fifth Federal Reserve District
Estimated—November 20, 1946

Total assets of borrowers ($ thousands)	Number of loans	Per cent of total number	Amount of loans ($ thousands)	Per cent of total amount
Over 5,000	655	1.5	86,619	17.4
750 - 5,000	1,269	3.0	88,532	17.8
250 - 750	3,056	7.2	92,158	18.6
50 - 250	12,013	28.3	144,300	29.0
Under 50	24,690	58.1	74,418	15.0
Unclassified	814	1.9	10,867	2.2
All borrowers	42,497	100.0	496,894	100.0

Table 2

Commercial and Industrial Loans to Firms Organized Since 1942
Member Banks, Fifth Federal Reserve District
Estimated—November 20, 1946

Total assets of borrowers ($ thousands)	Amount of loans ($ thousands)			Number of loans		
	Total	Corporate	Other	Total	Corporate	Other
Over 5,000	350	350	—	14	14	—
750 - 5,000	6,948	6,506	442	51	43	8
250 - 750	8,206	5,626	2,580	202	80	122
50 - 250	23,071	7,788	15,283	1,390	418	972
Under 50	25,385	5,819	19,566	9,079	1,129	7,950
Unclassified	711	552	159	81	12	69
All borrowers	64,671	26,641	38,030	10,817	1,696	9,121

Table 3

Commercial and Industrial Loans by Maturities
Member Banks, Fifth Federal Reserve District
Estimated--November 20, 1946

Maturity	Amount ($ millions)	Per cent of total
Demand	87.1	17.5
Less than 90 days	118.8	23.9
90 days to 6 months	136.0	27.4
6 months 1 day to 9 months	26.6	5.4
9 months 1 day to 1 year	12.2	2.4
1 year 1 day to 2 years	22.6	4.6
2 years 1 day to 3 years	15.2	3.1
3 years 1 day to 4 years	9.2	1.8
4 years 1 day to 5 years	21.2	4.3
5 years 1 day to 10 years	45.0	9.0
Over 10 years	2.9	0.6
Total	496.9	100.0

Table 4

Percentage Distribution of V-Loans
Federal Reserve Bank of Richmond
September 1950 to October 1951

Size of Guaranteed Loans Authorized

Dollar amount of loans	Per cent of total number of loans
Under 25,000	22.9
25,000 to 49,999	17.1
50,000 to 99,999	8.6
100,000 to 249,999	17.1
250,000 to 499,999	20.0
500,000 to 999,999	5.7
1,000,000 to 4,999,999	8.6
5,000,000 to 9,999,999	0.0
10,000,000 and over	0.0
	100.0

Size of Borrower Receiving Loans

Assets of borrowers	Per cent of total number of loans
Under 25,000	0.0
25,000 to 49,999	17.1
50,000 to 99,999	14.3
100,000 to 249,999	34.3
250,000 to 499,999	8.6
500,000 to 999,999	14.3
1,000,000 to 9,999,999	11.4
10,000,000 to 49,999,999	0.0
50,000,000 and over	0.0
	100.0

Question 36

Discuss the effects of bank examinations on the lending policies of banks in your district, particularly as they apply to loans to small-business men. Distinguish if necessary between examinations by different authorities.

It might be well to preface the answer to this question by mentioning the close relationship between supervisory authorities and bankers in the development of credit policies and techniques. The development of new types of loan outlets, the changing needs of commerce and industry, and constant study by lending officers have given rise to many changes in lending policies during the past 15-20 years. As a consequence, many loans are made now that in earlier times would have been unsatisfactory or even unsound. It should be emphasized that new credit developments have evolved without restricting credit to any class of borrower and without any line of distinction being drawn in bank examinations between loans to large and small businesses or between one type of loan and another. In the development of these improvements bankers and examiners have learned much from each other, with the latter serving also as a medium for the dissemination--particularly to smaller banks--of new and improved methods of credit extension.

If specific faulty lending practices are observed by examiners, an effort is made to influence the bank's lending policies by suggesting that it be more analytical of credits applied for and granted and adopt sounder credit administrative policies. Some of the principal practices urged are the following:

1. The bank should obtain borrowers' agreements to repayments prior to credit extensions.

2. As a general policy, loans should be paid seasonally, at the conclusion of the specific need, or reduced regularly at intervals designated by the particular circumstances.

3. Detailed information should be obtained that will disclose the source, dependability, and adequacy of borrowers' funds available for debt retirement.

4. Risks inherent in concentrations of credit extended to the same or related interests should be weighed carefully; such concentrations should be avoided to the extent deemed appropriate after thorough analysis.

Experience shows that capable bankers obtain necessary credit data from small as well as large enterprises and that failure to secure such information is a consequence of the attitude of the bank management rather than non-availability of the information. It is generally true, however, that large businesses maintain more complete records of operations and are better equipped to furnish full credit information than are small concerns.

Examiners' appraisals of loans made by the great majority of member banks in the Fifth District do not disclose a significant number characterized by an unwarranted degree of risk. Well-calculated risks are taken readily, administered carefully, and in such circumstances the banks' exposure is not considered unduly high. Where this is the case there is little or no need for conscious influencing of lending policies, and examinations of such banks have no particular effect in this respect. In the absence of examinations of such banks, however, it is probable that legal regulations would not be observed as carefully as they now are and that competitive pressures might result in unsound credit policies.

In a relatively small number of banks, examinations have disclosed substantial amounts of loans involving a very high degree of risk. Here bank examination and supervision do have a direct impact on lending policies in pointing out unsound loans and in suggesting desirable changes in credit policy. Frequently loans regarded as unsatisfactory would be proper and sound if made on suitable bases and terms. It is the purpose of bank examination and supervision to promote lending policies that will serve best the interests of both borrowers and lenders.

The examiner's principal concern is the quality of individual loans, but there are times when he must question the aggregate loans of a bank in relation to prospective demand from depositors and the capital protection available. Instances of this sort are relatively few and ordinarily rise in banks whose portfolios include a high volume of substandard credits. In such cases, there is frequently an excessive risk in relation to capital protection, a general lack of flexibility in asset distribution, and a consequent danger of serious loss. These conditions are usually found in small banks whose management is not as alert, experienced, or as capable as desired. It is the responsibility of examinations and supervision to encourage such banks to pursue sound lending policies, to reduce the exposure resulting from unsound credits, and to gear the total loan volume to the ability of the bank to assume normal risks and maintain a sound and flexible asset position.

No supervisory authority with whom we have contact criticizes or discourages a small loan or a loan to a small-business man per se. In fact, these authorities prefer a wide distribution of loans to concentrations of credit to a few borrowers or to a limited number of industries.

We have not observed any differences in the practices of the various examining authorities with respect to loans to small business.