March 9, 1950

To: Board of Governors

Subject: Small Business Legislation

From: Mr. Vest

CONFIDENTIAL

There is attached a summary of a draft of proposed legislation which is under preparation at the White House with respect to aid to small business enterprises. It will be seen that the proposal involves a number of important questions.

Conferences have been held in the last day or two to discuss this legislation, attended by representatives of the White House, Bureau of the Budget, Treasury Department, Reconstruction Finance Corporation, Commerce, and others. The Board has been represented at these conferences. It is understood that March 15 is the goal for the completion of the preparation of this legislation.

Attachment

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SUMMARY OF PROPOSED "SMALL BUSINESS ACT OF 1950"

This bill would provide for insurance of bank loans to small business enterprises by the Secretary of Commerce; direct loans and purchases of securities from such enterprises by "Federal investment companies" to be chartered by the Secretary of Commerce; liberalizing amendments to the RFC Act; and technical aids to small business through the Commerce Department. The RFC would be made subject to supervision by the President or such agency as he might designate.

INSURANCE

The Secretary of Commerce would insure loans made by financial institutions for the benefit of small business enterprises up to an aggregate principal amount of loans not to exceed $250 million at any one time, subject to increase by the President after July 1, 1951 to $750 million.

Insurance for each institution would be on a portfolio basis; it could not exceed the amount of the institution's "insurance reserve" which would be 10 per cent of loans made by it less claims approved for payment by the Secretary, and this reserve would be subject to adjustment every six months. Not more than 90 per cent of any loan could be insured and aggregate loans to one borrower could not exceed $15,000. Maturity would be limited to five years and thirty-two days.

INVESTMENT COMPANIES

Organization. - The Secretary of Commerce would be authorized to charter "Federal investment companies" with a minimum capital and surplus of $1 million each. Each company would have nine directors, three appointed by the Secretary of Commerce and six by shareholders. Stock would be eligible for purchase by any bank (including any Federal Reserve Bank), corporation or individual. A member bank's subscription would be limited to 3 per cent of its capital and surplus; and a Federal Reserve Bank could subscribe not more than 3 per cent of the capital and surplus of its member banks. While it seems to be contemplated that the Reserve Banks will own stock of the companies, there is no requirement that they do so. If they should acquire a substantial amount of the stock and consequently elect a majority of the directors, the effect would be that these companies would be managed by the Reserve Banks and, at the same time, would be supervised by the Secretary of Commerce.

Insurance of Obligations. - Obligations of the investment companies could be insured by the Secretary of Commerce up to an aggregate amount at any one time not exceeding $50 million (with authority in the

President to increase this limit to $200 million after July 1, 1951). It is not clear how this insurance would be effected; and a question of policy arises as to whether it would be appropriate for obligations of private companies thus to be insured by the United States.

Authority. - The investment companies would be authorized: (1) to make loans to eligible business enterprises, either directly or in cooperation with banks, provided such participating banks hold stock in the companies; (2) to purchase common and preferred stocks of such enterprises; and (3) to purchase capital shares of industrial development corporations formed to supply capital to eligible business enterprises. It should be noted that the companies would not derive profit from the administration of an insurance program since insurance of business loans would be separately administered by the Secretary of Commerce.

Exemptions. - The investment companies would be given a preferential tax status similar to that now given to regulated investment companies, that is, if they distribute to stockholders as dividends at least 90 per cent of their net income they would be entitled to deduct such dividends from their "net income" for tax purposes. In addition, they would be allowed certain concessions for a temporary period not given to ordinary investment companies, such as the right to build up reserves. Shares and obligations of the companies would be exempted from the Securities Act of 1933. Since these companies would have such benefits and since their obligations could be insured, it might be possible for existing investment companies to convert all or part of their operations into companies established by this bill, but it is not clear whether this would be feasible.

RFC AMENDMENTS.

The bill would make the RFC subject to the supervision of the President or to the head of such agency as he might designate. The authority of the RFC to lend to small businesses would be liberalized by modification of requirements for collateral, extension of maturity from 10 to 15 years, and by increasing the percentage to which the corporation may participate with banks.

REPEAL OF SECTION 13b

Section 13b of the Federal Reserve Act would be repealed immediately but the Reserve Banks would be authorized to carry out agreements heretofore made under that section. Amounts received by the Federal Reserve Banks from the Secretary of the Treasury under section 13b would be required to be paid to the United States within sixty days.

TECHNICAL AIDS

The Secretary of Commerce would be directed to give primary emphasis to the requirements of small business in providing technical and managerial aids to business enterprises and to establish a clearing house for the collection of administrative, technical and managerial information.

MISCELLANEOUS

The Secretary of Commerce could delegate any of his activities under this bill to such officers, agencies or corporations of the Government as he may designate.

The President would be given authority to "cut back" any existing Governmental program for financing businesses by reducing the maximum authorized amounts, maximum maturities or maximum percentage of insurance or participation by the Government, if the President determines that such action is necessary to coordinate the business-aid functions of the Government with general economic and fiscal policies.

The Secretary of Commerce would have authority to determine what business enterprises would be eligible for aid under the bill, but no enterprise could be considered a small business enterprise if it is operated as a subsidiary of any other enterprise.

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