

QUESTIONS ON TENTATIVE PROPOSALS FOR CHANGES IN
MAY 1, 1950 DRAFT OF PROPOSED "SMALL BUSINESS ACT OF 1950"

In accordance with an oral request received by the Board from the Budget Bureau, the attached draft of suggested changes in the White House draft of the "Small Business Act of 1950" has been prepared by the Board's Legal Division. These suggested changes would rewrite Title II of the proposed Small Business Act to place the national investment companies under the supervision of the Board of Governors instead of under the Commerce Department and also would make certain other changes in the White House draft to conform to the revision of Title II.

A number of questions have arisen in connection with the drafting and some of the more important questions for determination are indicated below.

1. Small-Business Finance Council.

Should there be a Small-Business Finance Council with authority to determine general policies under which the national investment companies would operate? The latest draft of revision of Senator O'Mahoney's Bill provides for such a Council, consisting of the Secretaries of the Treasury and Commerce, the Chairmen of the Board of Governors, and two members representing the investment companies and the Federal Reserve Banks owning stock in such companies. A similar provision is included in the attached draft.

2. Definition of Eligible Businesses.

What agency should determine the eligibility of business enterprises under the bill? The White House draft authorizes the Secretary of Commerce to establish general classifications of business enterprises eligible for aid under the bill. The latest draft of the O'Mahoney Bill would authorize the Small-Business Finance Council to establish standards for the determination of the eligibility of business enterprises; and this provision is followed in the attached draft. Under the attached draft, however, the Secretary of Commerce would continue to have authority to establish classifications of business enterprises for the purposes of the Binson Plan and other provisions of the bill except Title II.

3. "Public" Directors of Investment Companies.

Should three of the nine directors of an investment company be appointed from the public by the organizing Federal Reserve Bank with the approval of the Council, as provided in the latest draft of O'Mahoney Bill, or should all of the directors be elected by the shareholders but with a provision that, so long as any stock is owned by a Federal Reserve Bank, a majority of the directors will be elected by the Reserve Bank? The attached changes follow the O'Mahoney draft.

4. Tax Provisions.

The White House draft contains detailed provisions amending the Internal Revenue Code under which the national investment companies would be treated as "regulated investment companies" with some modifications relaxing requirements as to diversification of assets, permitting operating losses to be carried over, permitting the accumulation of a tax-free reserve to a limited extent, and with other differences. The latest draft of the O'Mahoney Bill would merely exempt the companies from all taxation for a period of fifteen years. The draft of suggested changes does not attempt to resolve this question but merely states, without any definite recommendation, that the tax provisions should be liberal enough to facilitate the chartering and successful operation of the investment companies.

5. Who may obtain charters for investment companies?

The White House draft contemplates in effect that the Secretary of Commerce may grant a charter for a national investment company to any group of persons, whereas the O'Mahoney draft provides that only the Federal Reserve Banks could obtain such charters -- but the Reserve Banks would be required upon request to sell their stock in the corporations at prices approved by the Board. The attached draft of suggested changes also provides for the organization of such companies only by the Federal Reserve Banks, for otherwise many groups might come in and ask for charters, with the Federal Reserve Banks supplying part or all of the capital funds. These might be difficult to resist in some cases, even though the public interest might not be served thereby.

6. Types of Businesses Eligible.

Should assistance be available only to businesses which are both small and independent or should assistance be available, as under the latest draft of the O'Mahoney Bill, to either a business which is small or a business which is "independent"? The attached draft provides for assistance only to businesses which are both small and independent.

7. Insurance Authority (Bimson Plan).

Should the investment companies be given authority to insure loans similar to that given the Secretary of Commerce? Under the proposed changes, the Secretary would be required to use the national investment companies as agents in administering his program of insurance of loans to the fullest extent practicable. Accordingly, no authority is contained in the draft of suggested changes for the insurance of loans by the investment companies as principals in their own right.

8. Compensation of Members of Council.

The latest O'Mahoney draft provides that the compensation of the two nongovernmental members of the Small Business Finance Council will be fixed, respectively, by the Federal Reserve Banks and the national investment companies and will be paid from funds derived by the Board from assessments on Federal Reserve Banks. If this is to be the method of compensation, should it not also be provided that the compensation so fixed will be subject to the approval of the Board of Governors? The attached draft of changes would so provide.

9. Limitation on Amount of Stock Owned by a Single Stockholder or Group of Stockholders.

The latest draft of the O'Mahoney Bill contains a provision under which the aggregate amount of stock in the investment companies owned by any member bank or by any other person, or by any group or class of persons, may be limited by the Board of Governors. It also provides that no single stockholder may own more than 10 per cent of the stock of any one company without the Board's approval. These provisions have been retained in the attached draft of changes. Are they desirable?

10. Function of Commerce Department.

The White House draft would authorize the Secretary of Commerce "to advise and assist in the establishment of national investment companies". This, of course, was logical under the White House draft because it contemplated that such companies would be established under the supervision of the Department of Commerce, but the provision has been stricken out in the attached suggested changes. However, it is to be noted that the President's message contains a statement that "the Secretary of Commerce should be authorized to assist in the promotion of these companies and to advise the Federal Reserve Board on how the investment companies can best contribute to accomplishing the objectives of the Government's Small Business Program." It may be considered that the proposed Council would carry out the intent of this part of the President's message, but the point is raised for consideration.

5/8/50