

September 2, 1944

Mr. Ralph E. Flanders, President,  
Federal Reserve Bank of Boston,  
Boston, Massachusetts.

Dear Ralph:

I have yours of August 29 in which you advise that the Massachusetts Section of the A.B.A. is holding a meeting on Post-war and Transition Industrial Financing at Boston on September 11. You evidently expect that our 13b amendment will be discussed and you advise that you are anxious to find some way of getting it before the meeting in favorable terms. I appreciate very much your interest and initiative in preparing yourself to defend this measure which, if enacted, would help materially in the impending transition and reconversion period.

As you may have noticed, there has been widespread misconception of the purposes of the bill. It is particularly exasperating to find that some financial papers, undoubtedly under promptings by misguided bankers, have falsified the issues and confused the public. Two notable examples were recent editorials appearing in the New York Journal of Commerce and the New York Herald Tribune. Since these editorials reflect typical misconceptions, I thought it might be helpful to you to have before you, and I am accordingly sending you herewith, a copy of my letter to the editor of the Journal of Commerce pointing out the misstatements and false reasoning in his editorial.

As requested, I am also sending you herewith a copy of the proposed legislation as it would appear with the amendments which I submitted during the hearings. I am also enclosing a copy of a statement which was made a part of the record by Senator Wagner when he introduced S. 1918 last May. This statement is more in the nature of general information respecting the need for the legislation and its purposes but does not point up the questions which have since arisen such as those involved in the letter I wrote respecting the editorial in the Journal of Commerce.

Based upon the discussion of this measure since it was introduced last May, I believe the most fundamental misconception

Mr. Ralph E. Flanders

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is that the bill would put the Federal Reserve Banks and the Government further into the field of commercial and industrial lending and would extend the control of the Government over the private banking system. It has even been claimed that the bill would contribute to the "socialization of credit". The bill would do precisely the opposite. This is not a bill to empower the Federal Reserve Banks to make loans. It is a bill which removes the present authority to make direct loans. It is a bill which will broaden and extend the field of lending by the private banking system and will provide them with the means of competing successfully and safely with the credit agencies of the Government which will otherwise be under great pressure to extend direct credit during the reconversion period either through loans or through sales of surplus property on credit. Without the enactment of this measure, there will be greater pressure upon Congress to increase the present authority of governmental credit agencies such as the RFC and the Smaller War Plants Corporation to extend direct credit of all kinds. In connection with this particular issue, I enclose also a brief excerpt from the record of the Senate hearing containing an interchange between Senator Hawkes and myself.

Although I am not at liberty to give you any details and do not wish to be quoted, I think it is most likely that the A.B.A. at their forthcoming national convention in Chicago will back-track on their resolution of last year against guaranteed loans during the postwar period. They will probably find it possible to change their position and still save face by giving our bill a blessing providing the authority is limited to a very few years after its enactment.

With best wishes, I am,

Sincerely,

*M. S. Eccles*

M. S. Eccles,  
Chairman.

Enclosures

LC/mg

cc: Miss Benton ✓

*Copy of letter to Journal  
of Commerce in  
General files*

H.R. 4804 AS ORIGINALLY INTRODUCED  
SHOWING CHANGES SUGGESTED BY CHAIRMAN ECCLES  
(Language suggested by Chairman Eccles is underscored)

A BILL

To amend section 13b of the Federal Reserve Act, as amended.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 13b of the Federal Reserve Act, as amended, is amended to read as follows:

"SEC. 13b. (a) Each Federal Reserve Bank is authorized (1) to guarantee a financing institution against loss of principal or interest on any loan made to a business enterprise and (2) to make commitments to purchase and thereafter to purchase from a financing institution any loan made to a business enterprise. No Federal Reserve Bank under this section shall guarantee, or make a commitment to purchase, more than 90 per cent of the amount of any loan.

"(b) Each Federal Reserve Bank shall pay to the Board of Governors of the Federal Reserve system, upon request of the Board, the aggregate amount which the Secretary of the Treasury has heretofore paid to such bank under the provisions of this section. The amount of \$139,299,557 (the amount which was paid by the Federal Reserve banks for stock of the Federal Deposit Insurance Corporation), less all amounts heretofore paid to the Federal Reserve banks by the Secretary of the Treasury under the provisions of this section, shall be paid by the Secretary of the Treasury to the Board upon its request; and for the purpose of enabling the Secretary of the Treasury to make such payment, the unexpended balance of the appropriation made by the last sentence of subsection (e) of this section as originally enacted by the Act of June 19, 1934, and now carried on the books of the Treasury under the title 'Payments to Federal Reserve Banks for Industrial Loans' (sec. 13b, Federal Reserve Act, as amended), is hereby made available. All amounts paid to the Board under this section shall constitute a fund which shall be utilized by the Board, on such basis as the Board may deem proper, to provide for losses (which may in the Board's discretion include expenses to the extent not covered by earnings) heretofore or hereafter incurred by Federal Reserve Banks through operations under this section. From time to time the Board shall make payments out of such funds in such sums and to such Federal Reserve banks as the Board may deem necessary to provide for any such losses. The Board may deposit all or part of such fund with any Federal Reserve bank, subject to the Board's order, and may, in its discretion, invest any part of such fund not currently needed for the purposes of this



section in obligations of the United States or obligations fully guaranteed by the United States as to principal and interest; and any income derived from such investments shall be added to and become a part of such fund. The determination of the existence and amount of any loss incurred by a Federal Reserve bank through operations under this section shall be made by such bank with the approval of the Board. Whenever a payment has been made under this section to a Federal Reserve bank to reimburse it for any loss, any amount subsequently recovered by such bank which reduces the amount of the loss for which such bank has received reimbursement shall be paid to the Board and shall become a part of such fund.

"(c) The stock of the Federal Deposit Insurance Corporation heretofore subscribed for by and issued to each Federal Reserve bank is hereby transferred to the United States. The certificates of stock of the Federal Deposit Insurance Corporation heretofore issued to the Federal Reserve banks shall be surrendered and canceled and appropriate evidence of the ownership of such stock by the United States shall be issued by the Corporation to the Secretary of the Treasury. Neither the Board nor any Federal Reserve bank shall hereafter have any obligation or liability to the United States or to the Secretary of the Treasury by reason of this section, as heretofore or now existing, or by reason of any action pursuant thereto.

"(d) No Federal Reserve Bank shall make any guarantee or commitment under this section if the aggregate amount of guarantees and commitments made by all Federal Reserve Banks under this section and then outstanding equals or exceeds four times the then existing amount of the fund provided for in subsection (b) hereof as such fund may have been increased or decreased in accordance with the provisions of such subsection.

~~"(d)~~ (e) All actions and operations of the Federal Reserve banks under this section shall be subject to such regulations, limitations, and conditions as the Board of Governors of the Federal Reserve System may from time to time prescribe.

"(e) (f) The provisions of the Securities Act of 1933 shall not apply to any obligation evidencing a loan all or part of which is guaranteed or is the subject of a commitment pursuant to the provisions of subsection (a) of this section.

"(g) No Federal Reserve Bank shall make any guarantee or commitment under this section after December 31, 1949, but this shall not affect the power of any Federal Reserve Bank to disburse funds under, or carry out, any guarantee or commitment made pursuant

to this section prior to or on such date, or to take any action deemed by it to be necessary to preserve or protect its interests in any amounts advanced or paid out in carrying on operations under this section. As soon as practicable after such date, the amount of the fund provided for by subsection (b) hereof, as increased or decreased in accordance with such subsection and as determined by the Board of Governors of the Federal Reserve System, shall be paid to and become the property of the United States. Such payment shall be made in such sums and at such times as, in the judgment of the Board, orderly liquidation of operations under this section will permit."

PLAN FOR INDUSTRIAL LOANS BY COMMERCIAL BANKS  
GUARANTEED BY FEDERAL RESERVE BANKS

Extent of the Need

In the shift of production from war goods to civilian goods, many business enterprises will find themselves in need of additional funds to finance their operations. This need is imminent since the changing requirements of the armed services are necessitating a growing volume of cancellations and curtailments. The need will become much more extensive when the volume of production for war declines at the time of armistice, whether on one front or both fronts, and the volume of civilian production needs to be increased accordingly. While it can be expected that after the settlement of war contracts American business as a whole will have a greater volume of liquid assets than ever before, this condition will not be uniform. Numerous enterprises will not be able to resume peacetime operations without financial assistance, in many cases beyond that available from private sources upon terms which will meet the borrower's requirements. Among such concerns will be those which have invested heavily in plant facilities and equipment in relation to their cash position, those who propose to change the type of product previously manufactured, and those that have had no war contracts and have suffered drastic curtailment during the war. Again, some contractors, in order to avail themselves of a favorable opportunity for purchasing Government-owned facilities and inventory, may require a larger amount of credit than can be obtained upon terms customarily granted by banks. Such situations may occur before settlement of cancelled contracts as well as thereafter.

In these and other circumstances, some degree of financial assistance from the Government will be necessary to encourage private financing institutions to extend the type of credit indicated if the production of such businesses is not to be curtailed or entirely lost. It is important, therefore, that some governmental agency be given the authority now to facilitate the extension of credit in the situations indicated, during the period of cancellations of war contracts as well as during the reconversion period and thereafter. It would be highly preferable that the agency so empowered should be permanent in character and should have no incentive to compete with private lending institutions. Agencies which are set up for the exclusive purpose of extending Government credit have a tendency to maintain the volume of their business even after the need for such credit may have declined. Therefore, to guard against competition with private financing institutions and to insure the tapering off of operations of the agency whenever conditions warrant, it is proposed to give this responsibility to the Federal Reserve System, which has permanent functions other than the loaning of money and is interested in maintaining private banking and credit on a sound basis.



### Limited Authority of Federal Reserve Banks under Present Law

Under section 13b of the Federal Reserve Act, the Federal Reserve Banks are authorized to make credit available to business enterprises, either directly when such credit is not otherwise available or through participation with commercial banking institutions. Such loans, however, may be made only for the purpose of providing working capital, must have maturities not exceeding five years, and may be provided only for established businesses. Because of such restrictive provisions of the statute, the Federal Reserve Banks have not been able to make credit available to many deserving business enterprises; nor would they be able to assist to an important degree in financing such enterprises henceforth.

### Authorization to Federal Reserve Banks to Guarantee Loans

In order to remedy these defects in the present law and to meet the need described above, it is proposed that, in lieu of the existing authority of the Federal Reserve Banks to make loans to business and industry under the restrictions noted, these banks be authorized to guarantee financing institutions against loss on loans made to business enterprises or to make commitments to purchase loans so made. Such guarantees and commitments by the Federal Reserve Banks would be available in proper cases to any financing institution, whether or not a member bank of the Federal Reserve System. The procedure followed in making such loans and guarantees would be generally similar to that which has been used in financing war production under the V loan program. However, a Federal Reserve Bank would execute the guarantees as principal and not as fiscal agent of the Government. A borrower would be expected to apply for such a loan through his usual banking connection. The bank would in turn make application to the Federal Reserve Bank of its district for the guarantee. General regulations governing the policy and procedure relating to the program would be issued by the Board of Governors of the Federal Reserve System.

### Qualifications of the System for the Task

The twelve Federal Reserve Banks and their twenty-four branches are in a position to extend this service economically and efficiently. The officers and employees of the Federal Reserve Banks have gained wide experience in administering the V loan program, in addition to that gained since 1934 in making loans to business enterprises under the existing provisions of the law. Financing institutions and borrowers alike are familiar with the services of the Federal Reserve Banks in this field. The authority to guarantee loans to business enterprises, therefore, could be put into effect without delay and the credits consummated expeditiously. Moreover the Federal Reserve System has important responsibilities in the credit field and in the supervision of banks and, since the loans in all cases would be made by private banking institutions, the guaranteeing of such loans by the Reserve Banks would not be competitive with the private banking system.

Such guarantees would be available for any types of loans made by financing institutions to business and industry, to meet situations of the various kinds referred to in the first part of this statement. Such loans could be made on a short term or long term basis and to provide either working capital or facilities. They would assist both in the financing of the resumption of peacetime operations and thereafter in meeting the needs of deserving business enterprises which cannot be adequately supplied by private credit agencies without some degree of assistance.

It is contemplated that the guarantees by the Reserve Banks under this authority would not exceed 90 per cent of the amount of the credits, since any enterprise which has reasonable prospects of successful operation should be able to obtain financing in which its bank assumes at least 10 per cent of the risk under the loan.

#### Fund for Meeting Losses

Being banks of issue, the Federal Reserve Banks could not be expected to utilize any large proportion of their own funds in making credit of this kind available without some protection against losses which might be incurred. There is, however, a fund which can be made available for use in meeting losses incurred by the Reserve Banks in guaranteeing loans, without any new appropriation by Congress.

The Secretary of the Treasury is authorized by existing law to pay to the Federal Reserve Banks approximately \$139,000,000 (the amount which these banks were required by law in 1933 to subscribe for stock of the Federal Deposit Insurance Corporation) for the purpose of enabling the Reserve Banks to make loans to business and industry. This amount has already been appropriated by Congress for this purpose. Under this existing authority approximately \$27,000,000 has been paid. The proposal would require the payment of the remaining \$112,000,000 of this appropriation to the Board of Governors and also would require the Federal Reserve Banks to pay to the Board the approximately \$27,000,000 which they have heretofore received from the Secretary of the Treasury under the present authority. The entire amount thus paid to the Board would constitute a fund to be utilized to provide for losses incurred by the Federal Reserve Banks in connection with loans to business and industry. The Board would have authority to invest any part of this fund not currently needed in obligations of the United States, and any income derived from such investments would be added to the fund and thus become available to meet losses on guaranteed loans. The stock of the Federal Deposit Insurance Corporation heretofore subscribed for by the Federal Reserve Banks would be transferred to the United States.

The use of this fund in this way, it is estimated, would permit guarantees of loans in an aggregate amount outstanding at any one time of at least one-half billion dollars.

4/28/44



"Senator Hawkes. As I listened to this, the purpose of it seems to be to stimulate banks to make loans so that business can proceed with the least possible delay and they are able to make a loan that they otherwise could not make, is that correct?

"Mr. Eccles. That is correct. All it does is to supplement what the banks can now do. The banks can make any loan they choose to make without any guaranty, except that it must be subject to the check of the banking examiners, and if the loan is of a questionable character, it is criticized.

"Senator Hawkes. Will this tend to eliminate that criticism?

"Mr. Eccles. Oh, yes; certainly that is the point. It makes it possible for the banks to make advances they otherwise would not make, and if they do not make them, then business will come directly to the Government for Government loans. Then you will be under political pressure to create some agency with the money to go directly into the lending business. What we are trying to do here is to avoid the pressure from business to get the Government to make direct loans because they cannot get credit from their banks. I would like to see the banks put in a position where they can take care of all the loans that can be made and thus avoid the necessity of the Government making direct loans, which they will be under pressure to make if there are loans which the banks will not make."

[Excerpt from record of Senate hearing on S. 1918]

FEDERAL RESERVE BANK  
OF BOSTON

RALPH E. FLANDERS  
PRESIDENT

August 29, 1944.

Honorable Marriner S. Eccles,  
Board of Governors of the Federal Reserve System,  
Washington 25, D. C.

Dear Marriner:

The Massachusetts section of the A.B.A. is holding a meeting on Postwar and Transition Industrial Financing here on September 11th. The A.B.A. on the whole is not too favorable to the legislation you are proposing. I am anxious to find some way of getting it before the meeting in favorable terms.

To assist me in doing so, will you please send me the proposed legislation in its current amended form together with any information which would be useful in making a favorable presentation.

I may say the members of our Board who were present at the last meeting favor the plan.

Sincerely yours,

*Ralph E. Flanders*  
President.

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