Form F. R. 511

TO Chairman Eccles

FROM Elliott Thurston

REMARKS: 2/8/45

Attached is Dave Kennedy's memorandum on the Federal Loan Agency set-up, and while long, it is difficult to condense so complex a subject. As Dave says, he could write a book on it.

The table on page 6 rather graphically shows the picture from the standpoints of loans and investments. Naturally, such further information as you may wish to have can be readily obtained; that is, so far as there is any public record.

E.T.

CHAIRMAN'S OFFICE

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

February 8, 1945

Mr. Thurston:

Attached is a memorandum for the Chairman on the Federal Loan Agency. The background material on the R.F.C. is rather detailed, but I felt that it should be included in order to give a picture of the powers and scope of operations of the R.F.C. The table, page 6, showing what has happened to R.F.C. loans and investments since 1939 will be of interest to the Chairman.

Howland Chase was very cooperative and helpful in this study.

FEDERAL LOAN AGENCY

The Federal Loan Agency was established under the Reorganization Act of 1939. There was no limit placed on the life of the agency. The Federal Loan Administrator supervised the administration and was responsible for the coordination of the functions and activities of the corporations under the Federal Loan Agency. The administrator was appointed by the President with the approval of the Senate. His term of office was not specified; his salary was fixed at $12,000. On February 24, 1942, the President by Executive Orders 9070 and 9071 issued under the First War Powers Act, 1941, transferred the housing agencies from the Federal Loan Agency to the newly created National Housing Agency and the lending agencies to the Department of Commerce. 1/

Under S 375, which passed the Senate on February 1, 1945, and is now before the House, the Federal Loan Agency is to be reestablished as an independent agency. The bill provides that the agency shall be "administered under the direction and supervision of the Federal Loan Administrator in the same manner and to the same extent as if Executive Order 9071, dated February 24, 1942, transferring the functions of the Federal Loan Agency to the Department of Commerce, had not been issued." The bill also provides (apparently in order to forestall the President from nullifying this action by a new Executive Order) that "no functions, powers, or duties shall be transferred from the Federal Loan Agency under the provisions of title 1 of the First War Powers Act, 1941, or any other law unless the Congress shall otherwise by law provide." The financial transactions of all Government corporations are to be audited by the General Accounting office according to the terms of the bill.

If S 375 becomes law, as now appears likely, the Federal Loan Agency will include the following corporations:

Reconstruction Finance Corp.
RFC Mortgage Co.
Federal National Mortgage Association
Disaster Loan Corp.
War Corporations:
- Defense Plant Corp.
- Defense Supplies Corp.
- Metals Reserve Co.
- War Damage Corp.

1/ These matters are covered in detail in the attached Senate Committee report on the bill.

The following corporations, which had been under the Federal Loan Agency prior to their transfer by Executive Order 9070 will remain under the National Housing Agency:

Federal Home Loan Banks
Home Owners' Loan Corp.
Federal Savings and Loan Insurance Corp.
Federal Housing Administration
Defense Homes Corp.

The following corporations, which had been part of the Federal Loan Agency, were transferred by Executive Order to the Foreign Economic Administration and presumably will continue under supervision of that agency:

Export-Import Bank
Rubber Reserve Co.
U. S. Commercial Co.
Petroleum Reserve Corp.

What should be the fate of the Reconstruction Finance Corporation when its Charter expires in January 1947, assuming that the war will be over by that time? There is a pronounced tendency for Government corporations and agencies to find reasons to perpetuate their existence and expand their influence. While the Reconstruction Finance Corporation was created as an emergency organization during the depression, its life has been extended so many times already that it is now generally looked upon as one of the so-called permanent Government corporations.

The war corporations should be continued so long as they perform a useful service in connection with the war and then they should be liquidated. Any of their properties or holdings essential to the security or defense of the country should be transferred to the War or Navy Departments; their other assets should be sold to the public. There are some who will advocate that the plants owned by the war corporations should be largely retained and operated by the Government as part of the Government's program to provide jobs for all after the war. This is on the assumption that private business cannot or will not take the risks necessary to provide full employment. Before the Government takes steps to enter fields of private business for this purpose, however, it would appear that it should first take forward looking action in other important fields, such as, social security, fiscal policy, labor policy, foreign trade, and public works programs.

There are three alternative courses of action that might be taken with respect to the nonwar activities of the Reconstruction Finance Corporation. First, as is most likely to be the case, it can be continued as a convenient instrument to take care of financial needs not provided for by private lending institutions. Second, part of its functions for which there appears to be no present need can be liquidated and others can be transferred to other Government agencies. Third, the entire Corporation can be liquidated without transfer of functions. In favor of the first alternative, it can be argued that there are marginal cases, or cases where private business cannot take the risk that should be provided by the Government with an outlet for necessary funds. Further, it can be maintained that this does not interfere with or compete with private business, since private business could or would not make the loans anyway. In case of depression, once the backlog of demand has been satisfied following the war, it would be an advantage to have a Government agency already set up and operating with broad powers in the lending field. In practice, however, the Corporation probably will in fact compete to a large or small extent with private institutions and might exercise powers in conflict with the aims of other Government agencies. There is no assurance that the Corporation would make certain that other sources of credit were not available in extending loans or that it would not exert a powerful influence on interest rates.

The second alternative, that of liquidating some functions and of transferring others, has considerable merit. For example, loans and preferred stock of banks could be largely liquidated and future needs could be handled by the Federal Reserve; loans to businesses could be handled through a Government guarantee arrangement such as provided in legislation now pending; and capital stock of and funds for other Government corporations such as the Export-Import Bank, Tennessee Valley Authority, and Federal Home Loan Banks could be provided directly by the Treasury. This would be a step forward in consolidating functions of Government agencies and end some of the overlapping of responsibilities.

The third alternative, that of liquidating the Reconstruction Finance Corporation, is probably least likely to happen and is perhaps the most undesirable. The record of the thirties has demonstrated that there is need for Government lending when private channels are unable to or will not meet the credit needs of financial and business institutions. The difficulties of the thirties are too fresh in the minds of many people to convince them that private lending institutions can and will provide for their credit needs in good times and bad times alike.

# BACKGROUND MATERIAL ON THE ORGANIZATION AND FUNCTIONS OF THE RECONSTRUCTION FINANCE CORPORATION AND ITS SUBSIDIARIES

## RECONSTRUCTION FINANCE CORPORATION

Organization and functions. The Reconstruction Finance Corporation was established in February 1932 "to provide emergency financing facilities for financial institutions, to aid in financing agriculture, commerce, and industry, and for other purposes." The Corporation's powers have been increased from time to time since the enactment of the basic law. During the war period it has created and operated a number of subsidiary war corporations to aid the war program. The life of the Corporation has been extended several times; under present law it would go into liquidation in January 1947.

The Corporation is managed, at least nominally, by a board of five directors, appointed by the President and confirmed by the Senate. As previously indicated, however, the Federal Loan Administrator supervises and coordinates the functions of the Reconstruction Finance Corporation as well as the other corporations under the Federal Loan Agency, and is in fact the operating head of the whole set up. The Corporation functions through a principal office in Washington and loan agencies in nearly all of the 36 Federal Reserve Bank and branch cities.

Kinds and terms of loans and investments. The Reconstruction Finance Corporation has a very broad scope of operations. The Corporation has power to make loans to banks, trust companies, and other financing institutions; mortgage loan companies, insurance companies, drainage, levee, and irrigation districts; self liquidating projects; credit unions; business enterprises; the mining industry; State funds created for the purpose of insuring deposits of public monies; receivers and conservators of banks and trust companies; railroads; individuals or associations for the carrying and orderly marketing of agricultural commodities and livestock; to States, counties, etc.; and to a number of other Government agencies.

It also has authority to purchase from the Public Works Administration securities acquired by that Administration in connection with loans made by it to railroads and to States and other public bodies; to purchase preferred stock, capital notes, and debentures of banks, trust companies, and insurance companies; and to make loans secured by such capital stock, notes, and debentures.

In connection with the defense and war programs the Corporation is authorized to provide financing for purposes of plant conversion and construction, working capital, mining operations and other activities; to provide war production facilities; to provide supplies of, and stockpile, strategic and critical materials; and to undertake a wide range of other activities incident to the war effort. These functions are carried out through a group of subsidiary corporations.

The Corporation is authorized to make its loans and investments upon such terms and conditions as it may determine to be consistent with the Reconstruction Finance Corporation Act. The interest rates and other terms of given classes of loans or on individual loans are determined by the board of directors from time to time.

Sources of funds. The Congress has increased the borrowing power of the Reconstruction Finance Corporation many times and for various purposes; the Corporation has not had to restrict its activities in any way because of lack of funds. According to the report on the George bill, the Corporation has a borrowing authority for upward of 14 billion dollars and on a revolving fund plan almost unlimited lending power. At the present time, the Reconstruction Finance Corporation gets its loan funds directly from the Treasury. At the end of August 1944, it owed the Treasury 9 billion dollars. Its guaranteed securities have all been retired, but it still has authority to issue guaranteed securities. The capital stock of the Corporation has been reduced from 500 million dollars to 375 million.

Volume of loans and investments. The variety and volume of loans and investments by the Reconstruction Finance Corporation at the end of 1939 and 1944 are shown by the table. Total loans and investments amounted to 10.4 billion dollars at the end of 1944. Nearly 8 billion dollars of this amount represented capital stock of and loans to the subsidiary war corporations and 658 million represented loans to industrial and commercial businesses for war purposes and loans to Great Britain. Nonwar loans and investments, other than interagency items, amounted to 866 million dollars at the end of 1944, declining by 696 million since the end of 1939. Further liquidation of these nonwar loans can be expected in view of the continuing high level of profits during the war.

## LOANS AND INVESTMENTS OF RECONSTRUCTION FINANCE CORPORATION
(In millions of dollars)

| | Dec. 31, 1939 | Dec. 31, 1944 | Change |
|---|---|---|---|
| Nonwar loans and investments | | | |
| Financial institutions | 172 | 30 | -142 |
| Loans on preferred stock of banks and insurance companies | 33 | 48 | +15 |
| Preferred stock, capital notes and debentures | 489 | 288 | -201 |
| Railroads (Including receivers) | 449 | 312 | -137 |
| Self liquidating projects | 79 | 34 | -45 |
| Drainage, levee, and irrigation districts | 84 | 39 | -45 |
| Securities purchased from Public Works Administration | 121 | 79 | -42 |
| Industrial and commercial businesses | 131 | 31 | -100 |
| Other | 4 | 5 | +1 |
| Total | 1,562 | 866 | -696 |
| Loans to industrial and commercial businesses for war purposes | -- | 371 | +371 |
| Loans to Great Britain | -- | 287 | +287 |
| Total loans and investments other than inter-agency | 1,562 | 1,525 | -37 |
| Preferred stock of and loans to Export-Import Bank | 45 | 174 | +129 |
| Loans to Rural Electrification Administration | 146 | 236 | +90 |
| Capital stock of and loans to RFC Mortgage Co. | 57 | 112 | +55 |
| Capital stock of and loans to Federal National Mortgage Association | 59 | 50 | -9 |
| Loans to Tennessee Valley Authority | 8 | 6 | -2 |
| Loans to Farm Security Administration | -- | 178 | +178 |
| Capital stock of Federal home loan banks | -- | 125 | +125 |
| Capital stock of and loans to war corporations | -- | 7,952 | +7,952 |
| Total loans and investments | 1,877 | 10,358 | +8,481 |

## RFC MORTGAGE COMPANY

The RFC Mortgage Company was organized under the laws of Maryland in March 1935. Its capital stock is owned and it is controlled by the Reconstruction Finance Corporation which appoints its board of directors and furnishes its loan funds.

The purpose of the RFC Mortgage Company is to aid in the (a) maintenance of a market for sound mortgages on urban income-producing properties when credit is not otherwise available at reasonable rates and terms, and (b) maintenance of a market for mortgages insured under titles I and II of the National Housing Act; and to facilitate the construction of war housing by the purchase of mortgage insured under title VI.

The Company considers applications for mortgage loans on urban income-producing properties such as apartment houses, hotels, business and office buildings to be made directly (1) to assist in the refinancing or aid in the reorganization of such properties which are in distress, (2) to finance the new construction of such properties, provided there is an economic need for such construction, and (3) to defray taxes and other fixed charges of such properties which are in distress through the loss of income directly attributable to the operation of wartime restrictions and regulations. Such loans are said to be made only upon compliance with the standards of the Company as to soundness and economic necessity, and only in instances in which credit is not otherwise available at reasonable rates and terms and when the net income from the property, after payment of taxes, insurance, and operating costs, is sufficient or will be sufficient in normal times to pay interest and the required amortization.

Totalloans outstanding by the RFC Mortgage Company at the end of August 1944, amounted to 101 million dollars.

## FEDERAL NATIONAL MORTGAGE ASSOCIATION

The Federal National Mortgage Association was organized by the Reconstruction Finance Corporation in 1938 under the provisions of the National Housing Act. Its capital stock is also owned by the Reconstruction Finance Corporation which appoints its board of directors and furnishes its loan funds.

The Federal National Mortgage Association is authorized to buy and sell and thus provide a ready market for insured mortgages. It is prohibited by law from making home mortgages directly to mortgagors if such mortgages are insured or acceptable for insurance under the provisions of Section 203 of the National Housing Act. It may, however, make directly to mortgagors large-scale housing loans secured by mortgages insured under Section 207 or Section 210 of the National Housing Act. It is also authorized to purchase uninsured mortgages up to 60 per cent of the appraised value of the property. At the end of August, 1944, total loans outstanding by the Federal National Mortgage Association amounted to 56 million dollars.

## DISASTER LOAN CORPORATION

The Disaster Loan Corporation was created in 1937 to make available special loan assistance in regions suffering from catastrophes such as earthquakes, hurricanes, and floods; the Corporation to have succession until dissolved by Congress. The Corporation is managed by officers appointed by the Reconstruction Finance Corporation, which owns all of its capital stock. Capital stock outstanding amounted to $24,000,000 at the end of August, 1944; the total capital funds that may be subscribed by the Reconstruction Finance Corporation now authorized by law is $40,000,000.

## WAR CORPORATIONS

Defense Plant Corporation. This Corporation is engaged primarily in the acquisition and expansion of industrial plant facilities for war purposes. It may engage in manufacturing or may sell or lease facilities to others engaged in manufacturing for war. The Corporation may also engage in any other activities deemed necessary by the President or the Federal Loan Administrator to expedite the war program. The assets of the Corporation amounted to 5.9 billion dollars at the end of 1943; later figures are not available.

The Defense Plant Corporation expects to dispose of the plants and facilities it has built and to liquidate when the war is over. Many of the plants are of a specialized nature which cannot be readily converted to manufacture of peace-time goods, and others may not be needed because existing privately owned plants of the type will be adequate to supply peace-time demands. The liquadation of such vast holdings will present many problems and might take considerable time.

Defense Supplies Corporation. This Corporation, the second largest of the war corporations, was set up to handle procurement of supplies and materials needed in the war. The Corporation makes loans to finance the development, production, and transportation of war materials. It may purchase or sell or otherwise deal in strategic and critical materials and supplies. It may also engage in the manufacture of arms, ammunition, and implements of war. Total assets of the Corporation amounted to 640 million dollars at the end of 1943.

Metals Reserve Company. The function of this Company is to provide a reservoir of strategic and critical metals and minerals necessary to the war. The assets of the Company, principally property which it holds for sale, amounted to 630 million dollars at the end of 1943.

War Damage Corporation. This Corporation provides insurance to owners of real or personal property against loss or damage resulting from enemy attack. It operates to a large extent through private organizations. Participating fire and casualty insurance companies assume 10 per cent of the risks and will receive a similar per cent of the profits on all policies written. The participating companies act as fiduciary agents for the Corporation in receiving applications, issuing policies, and collecting premiums. Claims have, of course, been very small and the Corporation will probably show a substantial profit upon its liquidation at the end of the war.