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COORDINATING BANKING POLICY WITH THE RECOVERY PROGRAM

The monetary part of the recovery program is calculated to expand rapidly the idle funds in the banking system for the purpose of encouraging banks to lend more liberally and to seek investments thus supporting the entire capital market. Hence there is presented the double problem of bank lending and bank investing as a part of the recovery program. It is, however, vain to expect that the banks will respond to the pressure of these idle funds unless an expansion in loans and investments can be readily effected under existing regulations and without criticism from any supervisory authority. Let us see what the situation is in this regard.

Expansion of bank loans. It is obvious that banks cannot hope to expand their loans to any substantial degree in so-called commercial paper, of which the supply is becoming increasingly limited from year to year. They must therefore seek other types of loans, particularly installment financing, medium- and long-term loans to businesses as well as real estate mortgages. The traditional aversion of bankers to non-liquid loans is still strong, although it has been offset by the recent revision of Regulation A which makes available to member banks Federal reserve credit against any sound asset. Discussions are now under way between the Federal bank supervisory authorities to synchronize bank examination policy with Federal reserve credit policy. Specifically it is proposed that the "slow" classification be eliminated from examination reports and that examiners look to the soundness of loans and not to their maturity. It is essential that agreement be had on this proposal so that an expansion of

loans by banks will not encounter any obstacles in the attitude of the supervisory authorities.

Expansion of bank investments. In the field of investment there are also important difficulties which should be met. These appear to be three in number, as follows:

1. Examination policy. Heretofore it has been the practice for examiners to criticise bond investments which are not of the highest quality, with particular emphasis on liquidity. Also, depreciation in the bank's investment account has been treated as a loss in determining net sound capital and with some variation by the supervisory agencies, such depreciation has in certain cases been classified as loss and required to be charged off. Discussions are now under way with reference to this problem and the Federal Reserve Board has already taken the position that no depreciation should be treated as loss except in certain classes of defaulted bonds and in stocks and that no computation of net sound capital should be shown on any report of examination. All Federal supervisory agencies should agree on such a program of liberalization in examination policy respecting bank investments.

2. The Comptroller's Regulation on Investment Securities. By process of evolution, the Comptroller's Regulation has become an extremely strict limitation upon the kinds of bonds that may be purchased by member banks. With minor exceptions, the Regulation limits purchases to registered securities unless exempt from registration. Also, the Regulation has been construed to put a blessing on the test of ratings by any two

of the four nationally-recognized rating houses. The result has been an almost complete drying up of local securities so far as bank investment is concerned. There is no use in supplying banks with idle funds for the purchase of additional investments so long as they are prevented from buying anything but the very highest grade issues which are already high in price and for which no additional support is needed. The real need is for support of second grade issues and local securities. The Regulation should be amended so that a bank could purchase either on the basis of ratings (this is the most convenient way for a banker to select a security) or of the banker's own information respecting the soundness of the issue. As to this latter category, a reasonable test would be a security such that the bank would be justified in making a direct loan to the obligor on the basis of the credit information in the banker's possession. The Regulation should be amended so as to synchronize with the recovery program.

S. E. C. Regulations. Without interfering with the general objectives of the Securities Act of 1933, it is believed that the S.E.C. regulations unduly restrict the issue of local securities.