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Senate 6/5/39
S2343

CHAIRMAN ECCLES' PROPOSAL FOR MEETING THE NEED FOR ADDITIONAL FACILITIES TO SUPPLY CREDIT AND CAPITAL TO INDUSTRY

The uncovered field

There are two groups of business enterprises whose needs are not adequately met by existing financial machinery:

1. Those who need short and intermediate credit but whose credit standing at the present level of business activity does not make them acceptable risks for banks. These are not misconceived or mismanaged or insolvent businesses, but businesses whose prospects of success are dimmed by the current economic situation.

2. Small and medium size businesses which need loan or equity capital for an intermediate or long period. The growth of nation-wide business units, the discontinuance of bank affiliates and of underwirting by banks, the increased cost of security issues, and the disappearance of local underwriters have made it difficult for this type of business concern to find long-time credit except at prohibitive cost.

The Mead bill

It is not likely that this bill will greatly increase the volume of loans made, for these reasons:

1. The insurance provisions are such as require the lending bank to take a 10 per cent loss on each loan before the insurance becomes effective for the remaining 90 per cent.

2. The rate of interest provided, 4 per cent, is so low for the type of loan contemplated that banks would be reluctant to make them, particularly as this would appear to give a preference to these borrowers over regular established customers.

3. The Reconstruction Finance Corporation has authority under existing law to do substantially all that the Mead bill proposes, except that the present law is interpreted as requiring the Corporation to pass on each individual loan. This could easily be changed.

Other undesirable features of the Mead bill are: (1) the creation of an unlimited contingent liability for the Government, and (2) authority to rediscount insured paper with unlimited maturities at the Reserve banks. In so far as member banks are concerned, they can now obtain advances on any satisfactory security, and in so far as nonmember banks are concerned, they should not be given the same privileges as those enjoyed by members - without being subject to the laws applicable to member banks.

Experience of the F. R. banks with industrial loans

The Reserve banks have approved commitments and advances to business of about $180,000,000 under section 13(b) of the Federal Reserve Act, but owing to limitations in the law that loans must be for working capital, must be made to established institutions, and must be for not more than five years, this arrangement does not meet the situation and the law should be repealed.

The proposal

It is proposed that funds in the Treasury now set aside or used for industrial loans - about $139,000,000 - be turned over to an Industrial Loan Corporation. This will involve no additional appropriation. The Board of Governors would be the Board of Directors of this corporation, and the twelve Federal Reserve banks with their twenty-four branches would be the field agents to pass on applications. In this way prompt and economical action would be assured by utilizing existing machinery and experienced personnel.

The corporation would make loans or commitments or acquire preferred stock; not more than $1,000,000 to one borrower. Intermediate or long-term loans could be made by private lenders, insured banks, protected by commitments of the corporation.

The corporation would have $100,000,000 of capital and $39,000,000 of surplus. It would have power to issue $500,000,000 of Government guaranteed debentures. Upon liquidation all remaining assets would go to United States Government. It would set aside out of its surplus $25,000,000 for an insurance fund for small loans not exceeding $25,000 - on the basis of guaranteeing 10 per cent of any lender's aggregate insured loans, so that the loss on any loan even up to 100 per cent would be absorbed by the Corporation, so long as aggregate losses did not exceed one-tenth of the lender's insured loans. This is the same plan as in Title One of F.H.A. The corporation's possible losses on insured loans would be limited to the $25,000,000 set aside as an insurance fund. Aggregate cost to borrower, including insurance and service charges would not exceed 6 per cent.

The purpose of the proposal is to meet adequately the existing need; the Federal Reserve System is proposed as agency because of the wide distribution of its existing offices, its close contacts with banks, and the experience of its personnel in this field, but any other arrangement that Congress may wish to make will be entirely agreeable.