4/25/44

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.

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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.

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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.

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