

Form F. R. 511

TO _____

FROM _____

REMARKS:

1/12/45

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CHAIRMAN'S OFFICE



PROPOSAL FOR GUARANTEE OF INDUSTRIAL LOANS BY FEDERAL RESERVE BANKS

The Baruch-Hancock Report on War and Postwar Adjustment Policies of February 15, 1944, recommended "as a permanent source of credit for small and medium-sized enterprises on a basis of broader risks than banks can be expected to assume, that the Federal Reserve System's authority to make industrial loans or commitments be expanded and liberalized. These loans should be made in such a way as to supplement, not compete with, private investment, for which enormous funds are available."

Companion bills, which would carry this recommendation into effect, were introduced on May 15, 1944, by Senator Wagner, Chairman of the Committee on Banking and Currency of the Senate, and by Representative Spence, Chairman of the Banking and Currency Committee of the House of Representatives. In introducing the measure, Senator Wagner had an explanatory statement with respect to the plan inserted in the Congressional Record. The text of this statement is as follows:

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 canceled 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. Be-

cause 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 can not 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 million dollars (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 million dollars has been paid. The proposal would require the payment of the remaining 112 million of this appropriation to the Board of Governors and also would require the Federal Reserve Banks to pay to the Board the approximately 27 million 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.

The bills S. 1918 and H.R. 4804, which were introduced in the Senate and House, respectively, on this subject, are identical. The text of these bills is as follows:

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.

"(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 (c) 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 in-

clude 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 fund 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) 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) 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."

FROM A LEGAL STANDPOINT

Administrative interpretations of banking laws, new regulations issued by the Board of Governors, and other similar material.

War Financing Contracts

The President of the United States on March 26, 1942, issued an Executive Order authorizing the War and Navy Departments and the Maritime Commission to enter into financing contracts to facilitate the prosecution of the war. There is published below the text of this Order together with a statement by the White House.

The White House, Washington, D. C.

March 26, 1942.

The Executive Order authorizing the financing of contracts to facilitate the prosecution of the war is aimed at curing a situation which has interfered with the all-out participation of many small business enterprises in war production. Senators Murray, Mead and Capper have been particularly anxious to bring about this participation. Full participation of the nation's smaller businesses is essential to victory.

The Order was prepared by the War Production Board, the War and Navy Departments and the Maritime Commission. It is the opinion of Messrs. Nelson, Patterson, Forrestal and Admiral Land that this order will greatly speed the war production of small business and subcontractors generally.

The basic purpose of the Order is to put working capital financing on a war basis. Up to now peacetime restrictions on banks and credit agencies have made it difficult for them to finance war production although the banks have been anxious to use their resources for prosecution of the war.

Under the Order, the War Department, the Navy Department, and the Maritime Commission may guarantee or make loans when they are needed for war production. These guarantees will support the operations of the banks, the Federal Reserve System, the Reconstruction Finance Corporation, and other credit agencies. They will not be made under peacetime credit rules. They will be made by production men, wherever additional financing is essential for additional production. Peacetime restrictions on credits cannot hold up production of war supplies needed by the armed forces.

The text of the order follows:

EXECUTIVE ORDER NO. 9112

Authorizing Financing Contracts to Facilitate the Prosecution of the War

WHEREAS in order that contracts of the War Department, the Navy Department, and the United States Maritime Commission (hereinafter referred to as Maritime Commission) which are now outstanding or may hereafter be entered into for war production, including the obtaining or conversion of facilities, may be promptly and effectively performed, it is essential that additional facilities be provided through governmental agencies to supply necessary funds to contractors, subcontractors and others engaged in such war production pursuant to such contracts;

WHEREAS the War Department, the Navy Department, and the Maritime Commission have available to them amounts appropriated by Congress which may be used for the purpose of making or guaranteeing loans, discounts or advances or commitments in connection therewith for the purpose of financing contractors, subcontractors and others engaged in such production or otherwise to expedite war production;

WHEREAS the guaranteeing or making of such loans, discounts, advances and commitments by the War Department, Navy Department and Maritime Commission will be expedited and facilitated by utilizing in this connection the Federal Reserve Banks and the Board of Governors of the Federal Reserve System, which are agencies of the Government exercising functions in connection with the prosecution of the war effort and which have offices and other facilities, including experienced personnel, located conveniently throughout the country and are in

close and frequent contact with banking and other financing institutions; and

WHEREAS the guaranteeing or making of such loans, discounts, advances and commitments will greatly facilitate the participation of small business enterprises in war production;

Now, THEREFORE, by virtue of the authority vested in me by the various provisions of the First War Powers Act, 1941, approved December 18, 1941, by all other Acts of Congress and by the Constitution of the United States, and as President of the United States and Commander-in-Chief of the Army and Navy of the United States, and deeming that such action will facilitate the prosecution of the war, I do hereby order as follows:

(1) The War Department, Navy Department and the Maritime Commission are hereby respectively authorized, without regard to the provisions of law relating to the making, performance, amendment or modification of contracts, (a) to enter into contracts with any Federal Reserve Bank, the Reconstruction Finance Corporation, or with any other financing institution guaranteeing such Reserve Bank, Reconstruction Finance Corporation, or other financing institution against loss of principal or interest on loans, discounts or advances, or on commitments in connection therewith, which may be made by such Reserve Bank, Reconstruction Finance Corporation, or other financing institution for the purpose of financing any contractor, subcontractor or others engaged in any business or operation which is deemed by the War Department, Navy Department or Maritime Commission to be necessary, appropriate or convenient for the prosecution of the war, and to pay out funds in accordance with the terms of any such contract so entered into; and (b) to enter into contracts to make, or to participate with any Federal Reserve Bank, the Reconstruction Finance Corporation, or other financing institution in making loans, discounts or advances, or commitments in connection therewith, for the purpose of financing any contractor, subcontractor or others engaged in any business or operation which is deemed by the War Depart-

ment, Navy Department or Maritime Commission to be necessary, appropriate or convenient for the prosecution of the war, and to pay out funds in accordance with the terms of any such contract so entered into.

(2) The authority above conferred may be exercised by the Secretary of War, the Secretary of the Navy or the Maritime Commission respectively or may also be exercised, in their discretion and by their direction respectively, through any other officer or officers or civilian officials of the War or Navy Departments or the Maritime Commission. The Secretary of War, the Secretary of the Navy, and the Maritime Commission may confer upon any officer or officers in their respective departments or civilian officials thereof the power to make further delegations of such powers within the War and Navy Departments and the Maritime Commission.

(3) Any Federal Reserve Bank or any officer thereof may be utilized, and is hereby authorized to act, as agent of the War Department, the Navy Department, or the Maritime Commission, respectively, in carrying out any of the provisions of this executive order, and the Secretary of the Treasury is hereby directed to designate each Federal Reserve Bank to act as fiscal agent of the United States pursuant to the provisions of section 15 of the Federal Reserve Act in carrying out any authority granted to it by or pursuant to this executive order. In any case in which any Federal Reserve Bank shall make or participate in making any loan, discount or advance or commitment as agent of the War Department, Navy Department or Maritime Commission under authority of this order, all such funds as may be necessary therefor shall be supplied and disbursed by or under authority from the War Department, Navy Department or Maritime Commission in accordance with such procedure as they may respectively require. Any amounts now or hereafter available under any appropriation act to the War Department, the Navy Department, or the Maritime Commission for the purpose of procuring materials, equipment or supplies, or of expediting production thereof, may be expended through the

any of the respective Federal Reserve Banks in accordance with the provisions of this executive order. In taking any action under any designation or authority given by or pursuant to this paragraph no Federal Reserve Bank shall have any responsibility or accountability except as agent of the War Department, Navy Department, or Maritime Commission, as the case may be.

(4) All actions and operations of any Federal Reserve Bank under authority of or pursuant to the terms of this executive order shall be subject to the supervision of the Board of Governors of the Federal Reserve System and to such directions and conditions as the Board of Governors of the Federal Reserve System may prescribe, by regulation or otherwise, after consultation with the Secretary of War, the Secretary of the Navy, or the Maritime Commission, or their authorized representatives.

(5) The War Department, the Navy Department and the Maritime Commission shall make reports of all contracts entered into by them respectively pursuant to the terms of this executive order, in accordance with the provisions of paragraph 1 of the regulations prescribed in Part II of Executive Order No. 9001 dated December 27, 1941.

(6) Interest, fees and other charges derived by the War Department, Navy Department and Maritime Commission, respectively, from operations pursuant to the terms of this executive order may be held by the Federal Reserve Banks and shall first be used for the purpose of meeting expenses and losses (including but not limited to attorneys' fees and expenses of litigation) incurred by the Federal Reserve Banks in acting as agents under or pursuant to the provisions of this executive order; and to the extent that the amount of such interest, fees or other charges is insufficient for this purpose the Federal Reserve Banks shall be reimbursed for such expenses and losses by the War Department, the Navy Department or the Maritime Commission, as the case may be.

FRANKLIN D. ROOSEVELT

THE WHITE HOUSE,
March 26, 1942.

Purchase of Government Obligations Amendment to Section 14(b), Federal Reserve Act

The President of the United States on March 27, 1942, approved an Act of Congress known as the "Second War Powers Act, 1942," Title IV of which amended subsection (b) of section 14 of the Federal Reserve Act so as to authorize the purchase or sale by the Federal Reserve Banks either in the open market or directly from or to the United States, in accordance with the provisions of section 12A of the Federal Reserve Act, of bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest, but limiting the aggregate amount acquired directly from the United States held at any one time by the twelve Federal Reserve Banks at not exceeding \$5,000,000,000. A time limit is placed upon this amendment to the Federal Reserve Act by another provision of the Second War Powers Act which provides that certain provisions of the latter Act shall remain in force only until December 31, 1944, or until such earlier time as Congress by concurrent resolution, or the President, may designate, and thereafter any provision of law amended thereby shall be in full force and effect as though this Act had not been enacted. Subsection (b) of section 14, as thus amended, reads as follows:

(b) To buy and sell, at home or abroad, bonds and notes of the United States, bonds of the Federal Farm Mortgage Corporation having maturities from date of purchase of not exceeding six months, bonds issued under the provisions of subsection (c) of section 4 of the Home Owners' Loan Act of 1933, as amended, and having maturities from date of purchase of not exceeding six months, and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision, or municipality in the continental United States, including irrigation, drainage and reclama-

tion districts, such purchases to be made in accordance with rules and regulations prescribed by the Board of Governors of the Federal Reserve System: *Provided*, That any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest may be bought and sold without regard to maturities either in the open market or directly from or to the United States; but all such purchases and sales shall be made in accordance with the provisions of section 12A of this Act and the aggregate amount of such obligations acquired directly from the United States which is held at any one time by the twelve Federal Reserve banks shall not exceed \$5,000,000,000;

Advances on Government Obligations Amendment to Regulation A

The Board of Governors, effective March 20, 1942, amended subsection (b) of section 2 of Regulation A entitled Discounts for and Advances to Member Banks by Federal Reserve Banks. This amendment makes no change of substance in the regulation, its sole purpose being to rephrase one paragraph of the regulation in order to make it clear that under the law the Federal Reserve Banks are authorized to make advances to their member banks for periods not exceeding 90 days on the promissory notes of such member banks secured by direct obligations of the United States. The section as amended reads as follows:

(b) *Advances on Government obligations.*—Any Federal Reserve Bank may make advances, under authority of section 13 of the Federal Reserve Act, to any of its member banks for periods not exceeding ninety days⁶ on the promissory note of such member bank secured by direct obligations of the United States, and for periods not exceeding fifteen days on the promissory note of such member bank secured (1) by the deposit or pledge of debentures or other such obligations of Federal Intermediate Credit banks having maturities of not exceeding six months from the date of

the advance, or (2) by the deposit or pledge of Federal Farm Mortgage Corporation bonds issued under the Federal Farm Mortgage Corporation Act and guaranteed both as to principal and interest by the United States, or (3) by the deposit or pledge of Home Owners' Loan Corporation bonds issued under the provisions of subsection (c) of section 4 of the Home Owners' Loan Act of 1933, as amended, and guaranteed both as to principal and interest by the United States.

⁶ The eighth paragraph of section 13 of the Federal Reserve Act authorizes advances to member banks for periods not exceeding fifteen days secured by bonds, notes, certificates of indebtedness, or Treasury bills of the United States. However, the last paragraph of section 13 authorizes any Federal Reserve Bank to make advances for periods not exceeding ninety days "to any individual, partnership or corporation" on the promissory notes of such individual, partnership or corporation secured by "direct obligations of the United States"; and the term "corporation" includes an incorporated bank.

Reserves

Balance in "Differential Account" Set Up Upon Purchase of Instalment Paper

The Board's opinion has been requested as to whether the balance in a "differential account" set up in connection with certain proposed contracts for the purchase of instalment paper by a member bank gives rise to a deposit liability against which reserves must be carried with the Federal Reserve Bank.

It appears that under these contracts the bank would purchase instalment paper at a price less than the face amount of the paper and that at the time of the purchase the dealer would be credited with the amount of the purchase price and full title to the paper would pass to the bank. Under the agreement, no further amounts would be credited to the dealer until "an amount in excess of the purchase price, plus . . . % per annum computed monthly of the unpaid balance of the amount paid by the bank for such paper, is realized by the bank"; and any excess so realized would be applied first to satisfy any past due indebtedness of the dealer to the bank arising under the contract or otherwise, and any balance then remaining would be paid or credited to the dealer.

In practice, it is understood that the transaction is handled in the following manner. At the time of the purchase, in order to maintain