7/9/45

MEMORANDUM TO MR. SNYDER FROM CHAIRMAN ECCLES

Proposed Transfer to Reconstruction Finance Corporation of "V" and "T" Loan Program

A short time ago, you and Mr. Fisher discussed with me a proposal to transfer to the Reconstruction Finance Corporation the guaranteeing functions of the War and Navy Departments and Maritime Commission under the "V" and "T" loan program, with the Federal Reserve Banks acting as fiscal agents for the Reconstruction Finance Corporation.

At that time I was not in a position to appreciate all of the implications of the proposal and it was necessary for me to investigate the matter further. I am now convinced that the proposal is unsound and that the plan would be impracticable and inadvisable.

Shortly after my discussion with you and Mr. Fisher, Colonel Mechem of the War Department advised me that he and General Carter had just found out about Colonel Cleveland's part in this matter and his memorandum on the subject. They were much embarrassed about Colonel Cleveland's activities, which had been taken without their knowledge or consent, and they thoroughly disapprove the plan. Colonel Mechem and General Carter have advised General Somervell of their strong objections both to the plan and the method used by Colonel Cleveland in proposing it.

I have also discussed this matter with Mr. Hinckley and he has stated to me that he too is opposed to the proposal. Moreover, when the matter was recently brought to the attention of the Navy Department's Advisory Committee of Bankers, I understand that they expressed opposition to the proposal and thought that it would be most inadvisable.

I can see nothing to be gained by putting this proposal into effect and there would be much to lose. Without attempting to elaborate, I would like to outline some of the reasons for my opinion.

Duplication of credit functions

The Federal Reserve Banks have been utilized in carrying out this program principally because of their long credit experience and, as a matter of operating procedure, the Services have left the credit aspects of the program largely to the Reserve Banks. However, the RFC, unlike the Services, is itself a credit agency with experienced credit personnel; and if the proposed transfer of functions is made, it is assumed that the RFC credit department would review loan applications and make recommendations to the RFC board.

Consideration of the credit aspects of guaranteed loans by both the Federal Reserve Banks and the RFC would result in wasteful duplication of effort and expense.

In this connection, I understand that Colonel Cleveland's proposal contemplates that the Federal Reserve Banks would act as agents for the RFC, not only under the "V" and "T" loan program, but also in connection with the Corporation's own program of deferred participations. In fact, he has stated that the plan would be of no value unless the two programs are combined. There is no relationship between these two programs and I see no purpose at all to be served by attempting to consolidate them in this fashion.

The proposal simply means that the facilities of the Federal Reserve System would be turned over to the RFC. The RFC would have full discretion and would make and control all policies. The function of the Federal Reserve Banks would be merely to carry out these policies. This would be true not only as long as the V-loan and T-loan programs may last but also permanently with respect to the deferred participation plan of the RFC. This in my judgment would be wholly impractical. If any change were to be made, it would seem more logical for the RFC to be substituted for the Federal Reserve Banks and the Board rather than for the Services, thus relieving the Federal Reserve Banks and the Board of any responsibility in the matter.

In the V-loan and T-loan programs the Board of Governors has had the important function of coordinating the operations of the Services with the Federal Reserve Banks. It has prescribed regulations governing the operations of the Reserve Banks and has established guarantee fees and maximum rates of interest. Under the proposal, however, the Board would hereafter have virtually no functions to perform in this connection. The Federal Reserve Banks would act under RFC directives rather than under policies of the Board.

Retarding effect upon the program

The adoption of the proposal could not help but complicate and retard the program of guaranteed financing of war production, with possible adverse effects upon production of war materials and upon the speedy financing of contractors whose war contracts are cancelled.

The necessity for continued close cooperation with the procurement branches of the Services would not be eliminated by the proposal. It is obvious that only the Services are in a position to be fully familiar with the needs of war production and of the war contract termination program, and, if the proposal is adopted, it would be necessary for the Services to be consulted by the RFC in practically all cases of guaranteed loans to finance war production and the termination of war contracts.

Recognizing this fact, the plan contemplates that liaison officers under the jurisdiction of the War Department would be retained at the various Federal Reserve Banks for the purpose of executing certificates of necessity and eligibility in connection with guarantees of war production and termination loans. Nevertheless, I understand that the proposal contemplates that the local loan agencies of the RFC also would have to be consulted in connection with the execution of such guarantees.

Consequently, it seems to me that the effect of the proposal would merely be to introduce into the program a new organization, together with its own field agencies, and that inevitably the functioning of the program would be impaired and slowed down.

Unfavorable reaction by bankers and borrowers

I have already indicated that certain bankers have expressed their opposition to the proposal. It seems to me that this opposition would be shared by bankers generally and by borrowers as well. Their dissatisfaction would result, not only from the slowing up of administrative procedures, but also from the fact that the change of guarantors would give rise to uncertainty with respect to the policies which would be followed by RFC and the manner in which hundreds of directives and interpretations of guarantee agreements made by the Services in the past would be administered in the future by a new organization.

At present, financing institutions under the "V" and "T" loan programs feel that they will share with the Services in amounts recovered by the United States under its statutory priority in the event of the bankruptcy or insolvency of a borrower. This statutory preference is not available to the RFC and would be lost if the RFC were substituted for the Services as guarantor. Consequently, the interests of financing institutions would be adversely affected in this respect.

Liquidation phase of program

If, when the V-loan and T-loan programs have reached the stage of liquidation, the armed Services feel that they want to get out of the financing business completely, there is no reason whatever why the winding up of the programs cannot be transferred to the Federal Reserve System. The Services would get out of the picture in this way just as completely as if the transfer were made to the RFC, and there is certainly much more reason for making the transfer to the Reserve System.

The Federal Reserve Banks are entirely familiar with these loans and are now servicing them. They would merely have to continue doing what they are now doing. They would continue to purchase the loans when "puts" are made, as they do now, and arrangements could be made to obtain from the armed Services such funds as may prove to be necessary for losses or otherwise. Whatever could be done to transfer the liquidation program to the RFC could likewise be done to transfer it to the Federal Reserve System. There is no reason for bringing an additional agency of the Government into the picture either now or when the program is merely one of liquidation.

Present program working well

The present war financing program has been in effect for over three years and is working smoothly and efficiently. The Federal Reserve Banks execute "V" loan guarantees in the field, without submitting the matter to Washington, up to $250,000 for the War Department and up to $100,000 for the Maritime Commission. In the case of "T" loans, they execute guarantees for both the War Department and Maritime Commission up to $500,000, where the guaranteed percentage is not more than 90 per cent and up to $100,000 where the guaranteed percentage is not more than 95 per cent. Where guarantees involve larger amounts and must be submitted to Washington for approval, it has been possible to establish a standard of expedition whereby the Services usually act upon the application within a 24-hour period. In the instances in which the Services have found it necessary or advisable to take over guaranteed loans, the "puts" or "purchases" have been processed expeditiously through arrangements worked out between the Services and the Federal Reserve Banks.

I have discussed this proposal with the members of the Board and also with the Presidents of the Federal Reserve Banks when they were recently here. They unanimously feel that the plan is unnecessary and would be inadvisable. If it should be decided to put the proposal into effect, they all feel that the entire program should be turned over to the RFC and the Federal Reserve Banks and the Board relieved of all responsibility in the matter.

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