

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

*File*  
**Office Correspondence**

Date May 23, 1945

To Mr. Thurston

Subject: Hearings on financial problems  
of small business before the House  
Small Business Committee.

From Mr. Cherry

Mr. Maury Maverick, Chairman of the SWPC, was the only witness this morning. The theme of his testimony was the advocacy of a loan insurance system for little business similar to FHA to be administered by the SWPC. Attached is a copy of Mr. Maverick's prepared statement.

During the questioning, Congressman Robinson stated that testimony in the field was almost wholly on the point of recommending the removal of Government restrictions and urging that the Government should not get deeper in business through the making of loans or the insuring or guaranteeing of loans.

Congressman Hall got Mr. Maverick to agree that if all Government restrictions which require banks to be liquid were removed and if tax restrictions were removed, as well as certain registration requirements of the SEC, his plan of insurance would not be necessary. Mr. Maverick stated, however, that the banks and individuals would have to lend as they did a number of years prior to the war.

Congressman Robinson also made the point that there was a considerable difference in insuring home loans and business loans. He pointed out that in business loans you have to insure management as well as other intangibles, and it was brought out that approximately 70 per cent of all small business fails in the first five years and that when a small business fails, creditors usually recover little more than 10 per cent.

Congressman Ploeser got Mr. Maverick to admit that the retail and wholesale business constitute a large part of small business enterprises and that SWPC has had no experience in this business. He also got Mr. Maverick to admit that the only experience SWPC had was in production for war; that it had no experience in the field of free enterprise during normal times. Mr. Ploeser then pointed out that SWPC's recommendations could not be given too great weight.

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Attachment

Statement by Maury Maverick, Chairman and General Manager, Smaller War Plants Corporation, on Financial Problems of Small Business, before the House Small Business Committee on May 23, 1945, at 10 a.m. in the Roads Committee Room, Room 1011, House Office Building.

Mr. Chairman:

Little business must have a loan insurance system like the FHA if there is to be prosperity for the country--and for business itself, and the banker. FHA has been successful for homes, and banks now welcome it, although they did not at first.

What has been done by the FHA in the field of building can be done in behalf of small business and all free enterprise, only on a much larger and wider scale. FHA meant some seven or eight billion dollars in building on which the banks did not lose a penny; it led indirectly to business of all kinds, to the extent of many more billions.

Cutbacks, When All In, Will Be A  
Tremendous Jolt to the Country

When all the cutbacks of this war are made, our employment, our business, could be slashed in half, if nothing is done. In any event, a mishandled situation, with returning soldiers and turned-out war workers, might mean frightful unemployment. For me to suggest the figure would cause people to say I was trying to be spectacular.

We must, therefore, view the problem of the coming peace with wide open eyes as the most serious period in our history. In war we all worked together magnificently. For some reason, although as a people we have through our Government waged war so successfully, we have in times of peace a tendency to take it easy, to let up, and to forget that the Government and the people must continue to work together.

Let Us Wage Peace As We Waged War--  
Together.

I urge we re-dedicate ourselves to democracy which has always saved us in the hour of peril. We must wage peace as we waged war--together, and with confidence in each other.

In urging loan insurance--WHICH IS THE OPPOSITE OF GOVERNMENT CONTROL AND CONCENTRATION--we do not advocate the abandonment of any of the people's <sup>legal</sup>~~constitutional~~ rights. For instance, insurance of bank deposits, the great work of the Federal Reserve System, the several thousand farm credit institutions, the enormous value of the RFC--and, I might add, in some modesty, the substantial achievements and present statutory powers of the Smaller War Plants Corporation, all of these should be held open to the American people.

Indeed, we believe all our present aids to little business, that is, direct loans, guarantees, technical advice and assistance, and the like, should continue to be available, as well as the others I have mentioned. In other words, although in my opinion this insurance plan will be the greatest

boon to banks and to small business ever instituted in America, I wish to emphasize that I do not advocate the giving up of present statutory aids to small business, nor do I exclude the desirability of other means of helping small business, such as tax relief.

The point is, I am talking about loan insurance for business, not other good things.

Small Business Is Unable to Raise  
Needed Funds. Present Sources  
of Credit Inadequate.

The first question is this: Does small business need a loan insurance program? The answer is YES. Existing sources of longer-term credit are inadequate, as I will show you.

There are three ways in which small businesses secure investment capital. They are:

First, through individual investment by the owners, friends and interested persons.

This method of getting capital was a good enough way in the older days of a rapidly expanding economy and before the present high tax rate on profits.

Today that avenue of financing small business expansion or the starting of new enterprises is practically closed.

Second, through issuance of securities.

The securities market is simply not for the little business man. The cost of advertising and floating issues is excessive. A study based on data collected by the Securities and Exchange Commission showed that the cost of small companies in

floating their securities runs from 15% to 17% of the total proceeds, which is about three to four times the cost for the large companies.

Third, loans from banks and other lending institutions. This is still the major source of funds for small business.

But banks have demand or short-term obligations to their depositors and cannot afford a long-term risk on any sizable share of their funds. Liquidity is now the watchword of banks in lending money. That is good for depositors, but not so good for small business.

SWPC Should Be Authorized by Statute  
to Set Up Insurance of Business  
Loans.

Due to present difficulties of small business in obtaining capital and credit, which I have only briefly outlined, we propose that the Smaller War Plants Corporation be authorized and directed by Congress to provide insurance of long-term business loans. It is to be like the FHA.

AMENDMENT PROVIDING BUSINESS LOAN INSURANCE SUGGESTED BY SWPC

In order to make a definite proposal, I offer an amendment to the SWPC Act, Public 603, 1942. The amendment is as follows:

The Corporation is hereby specifically empowered to establish a system of credit insurance, which shall be available to quali-

fied financial institutions making loans to small business concerns. To that end it may issue either blanket or single policies insuring such financial institutions against the amount of the first loss in a sum not exceeding twenty per centum of such loans, and may charge a reasonable fee for such credit insurance not exceeding  $1\frac{1}{2}$  per centum of the total amount of the loans insured, which shall be added to the reserve fund which is hereby authorized to be established for that purpose.

I do not propose a legal discussion or analysis. This can be referred to the House Drafting Committee if it is what you want, and then your Committee can make its own suggestions directly to the House itself.

Therefore, please permit me to get into the heart of the Business Loan Insurance problem itself.

Insurance System Is Prompt, But Safe.  
Guarantee System Is Full of Red  
Tape and Too Slow.

The plan applies to longer-term small business loans and is patterned after the successful system of the FHA. Its essential features are as follows:

1. The insurance would apply to eligible loans up to \$100,000. As an alternative, which might be better, no limit would be set on the size of loans to be insured, but the protection on any one loan could be limited to \$100,000.

2. The individual bank would be insured against aggregate losses from these loans up to 20%. If its losses exceed 20% of the insured loans, the bank would have to meet that excess loss itself. The FHA system originally insured loans up to 20% under Title I. As a result of experience, the protection was reduced to 10%. We recognize that certain arbitrary judgments must be made at the start of Business Loan Insurance program, and that these percentages will be adjusted as our experience grows.

#### Establishment of Reserves

3. Now about reserves. These would be created by an original commitment by the Government and an annual premium from each bank on loans insured.

The precise amount of the commitment by the Government must be determined on further study, but I estimate that \$100,000,000 will be ample.

The Government made an original commitment of \$200,000,000 for the reserves under Title I of FHA. Under Title II of the FHA, the Government exposed itself to guarantees of two billion dollars of small home loans.

Is there any one who will doubt that this commitment to start the system was worthwhile? I say that if it costs the Government one hundred million or two hundred million dollars to release billions of credit to small

businesses, it would be worth the candle, because it would light the candle of thousands of little businesses everywhere in America. It would certainly be worthwhile to all big business, because little businesses are their customers. It is worthwhile, because it permits expansion of our free enterprise system, which is absolutely essential for anything like full production and full employment.

We do not think this proposed reserve of \$100,000,000 will be used up. But the plan must start off with a strong safety factor. Looking to the experience of FHA, we find that total insurance under Title I, up to December 31, 1943, has amounted to one and three-quarter billion dollars. Claims paid out have totalled \$48,600,000, or 2.7%.

However, there have been \$20,200,000 of recoveries and salvage from the assets taken over. Therefore, the net loss was only \$28,400,000, or 1.6%.

Under all of the sections of the FHA Act, the volume of insurance extended to December 31, 1943, has amounted to \$7,341,000,000.

Since June, 1940, FHA has paid for itself out of operations.

\$100,000,000 is a large amount of money, but nothing in comparison to the approximately eight billion dollars a month we were spending on war. I say if we can spend eight billion a month in destruction of our enemies, we can spend a small amount for constructive purposes for our own country.



I propose that an annual insurance premium be paid by each bank equal to  $1\frac{1}{2}\%$  of its registered loans. After the plan is in operation a few years this rate should be reduced. FHA started off with no premium for its insurance of modernization loans under Title I. Then a premium of  $3/4\%$  was charged. On home loans a premium of  $1\%$  was charged originally and then reduced to  $\frac{1}{2}\%$ .

The annual premium of  $1\frac{1}{2}\%$  maximum may be interpreted as a surcharge on the borrower. But, again taking the FHA system as our model, we can be sure that with small loans insured against loss, the trend of interest rates charged by banks on small loans will decline as the risk to the bank is reduced or eliminated. The net cost to the borrower on an insured loan will be less than on the present system of individual and unsupported lending practices.

4. If the reserve for any year contributed by the banks is not exhausted by the losses in that year, the surplus remaining may be returned pro rata to the banks. An alternate plan would allow the excess reserves to accumulate, at least for the first few years after the plan goes into effect.

Returning the excess reserves to the participating banks makes the system a mutual one. However, on these two plans I do not want to give a final answer. They should be investigated carefully before a decision is reached.

Central Insurance Plan Can Be Operated  
Economically. It Will Increase  
Profits of 15,000 Banks, Too.

5. The administrative costs of the system will be paid for by government. I estimate this cost at about \$4,000,000 per year. This is an estimate, based on the experience of the SWPC, which operates on an annual budget of eight million dollars. We maintain 110 field offices and render many and diverse services to small business.

I am sure that a little business insurance plan, such as I have proposed, can be operated economically with the widest possible benefits to the 15,000 banks of the country, the millions of small businesses and the tens of millions of workers who are dependent on these small businesses, as well as big business and the general prosperity of the country. It would become a routine operation.

MIND YOU - - - !

Insurance

NOT separate guarantees

Let me emphasize that the foregoing is to be done on an aggregate insurance basis, NOT on the preaudited, individually inspected and time-consuming separate guarantee system. There is a major difference in the way a guarantee system works and a "portfolio insurance" plan. Our proposal would eliminate all the time-consuming red tape and pre-investigations. In other words, it would be prompt and the benefits would be spread throughout the country.

The insurance system is also better for the banker, because on this aggregate plan, he can, with reasonable diligence, come out with no losses. That is because he surely has enough experience not to lose over 20% in the aggregate, and for that matter, he will not lose that much. But in guarantees, he is bound to lose on some loans, as surely some will go bad.

Naturally, in addition to the accumulated experience and standards of the banks, there would be additional standards for the insurance. While the pre-audit is eliminated to save time, all cases will be reviewed afterward. In addition to assuring adherence to standards, post-review will show up methods of perfecting the system and reducing the cost of operation.

Trust the Banker's Judgment, Because  
He Is Conservative.

As for bankers, you can trust their judgment because they are conservative--and don't want to lose money.

The insurance feature is simple. I believe it will accomplish the desired result of liberalizing bank lending policies to small business. If the banks know that the first 20% of their losses are insured, they will be less restrictive and will be willing to aid financially small and new enterprises in their communities. At the same time they will be careful.

Don't forget that small loans are not bad loans. The experience of SWPC, with the loss ratio of less than 1%, is certainly assurance that a much more liberal attitude is

justified without undue risk. And in this connection it must always be borne in mind that SWPC does not authorize a loan directly to small business unless that loan cannot be placed with the applicant's local bank. Our record is based on "marginal" cases, and we do not compete against banks.

Insurance Plan Will Give Confidence to  
Country As Insurance of Bank  
Deposits Did

What I am here to tell you is that this will give confidence to the country and to the bankers. Bankers opposed the FHA and the insurance of bank deposits--but none do now; for this plan there may be some opposition, but I doubt if there will be much. As a matter of fact, the 15,000 banks of America will get the business themselves, and they will make more money because of the volume (just as in the FHA); they will be more independent, and such practice will spread business over the country.

What I am advocating is the free enterprise way of getting full production and full employment. This is no panacea, no nostrum, no coddling--it's the American way, somewhat routine, and according to accepted methods.

We propose this be administered by the SWPC because we have the know-how. Also, connected with this insurance plan would necessarily be technical and managerial advice which we have done successfully, plus the other features of this Act, which are known to you. I have not covered them, because I wish to emphasize the insurance plan, and there is already

considerable and substantial experience upon which to base the plan. We have the basic organization right now, 110 ~~district and fourteen~~ field offices, who have three years of experience in dealing with all the problems of little business.

Gentlemen, the financial problems of small business are claiming attention for everyone seriously interested in our country's welfare. Members of Congress, officers of the government, leading big businessmen as well as little businessmen have generally agreed that some provision must be made to make longer-term capital available to small business.

A Business Loan Insurance System, as I have indicated, is the answer.