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January 23, 1947.

Honorable Jesse P. Wolcott, Chairman,
Committee on Banking and Currency,
House of Representatives,
Washington, D. C.

My dear Mr. Chairman:

The Board of Governors of the Federal Reserve System recommends the enactment of the enclosed bill to repeal section 13b of the Federal Reserve Act, containing the existing industrial loan authority of the Federal Reserve Banks, and to amend section 13 of the Federal Reserve Act in order that the Reserve Banks may continue to guarantee loans to business enterprises but on a more effective basis.

The bill, in repealing section 13b, would require the return by the Federal Reserve Banks of all funds heretofore received by them from the Treasury in connection with their industrial loan operations and would eliminate any further claim upon the Treasury for any part of the \$139,000,000 which was appropriated for this purpose. The repeal of section 13b, coupled with the requirement for the return by the Reserve Banks of the funds received from the Treasury, would carry out the recommendation of the President, contained in his Budget Message for 1948, reading as follows:

"The Board of Governors has made a further recommendation, in which I also concur, that the Congress repeal the existing, largely dormant, authority of the Federal Reserve banks to make direct loans to industry, releasing to the Treasury the funds reserved for this purpose. The gold increment fund now includes 112 million dollars reserved for such loans, and an added 28 million dollars has been advanced to the Federal Reserve banks. These sums will be transferred to miscellaneous receipts."

In the judgment of the Board, it is also important that the authority of the Federal Reserve Banks to render assistance in financing business enterprises as contained in the proposed bill be available whenever conditions are such that it is needed. The reasons for the

Honorable Jesse P. Wolcott

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Board's recommendation of this bill are fully explained in the enclosed statement with respect to this matter. The Board hopes that the proposed bill will receive the favorable consideration of the Committee on Banking and Currency.

Sincerely yours,

M. S. Eccles,
Chairman.

Enclosures

GDV

A BILL

To repeal section 13b of the Federal Reserve Act, to amend section 13 of the said Act, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Section 1. Repeal of section 13b of the Federal Reserve Act.

Section 13b of the Federal Reserve Act is hereby repealed; but such repeal shall not affect the power of any Federal Reserve Bank to carry out, or to protect its interest under, any agreement heretofore made in carrying on operations under that section. Within sixty (60) days after the enactment of this Act, each Federal Reserve Bank shall pay to the United States the aggregate amount which the Secretary of the Treasury has heretofore paid to such bank under the provisions of section 13b of the Federal Reserve Act, together with any net earnings thereon for the period from January 1, 1947, to the date on which such payment to the United States is made; and such payment shall constitute a full discharge of any obligation or liability of the Federal Reserve Bank to the United States or to the Secretary of the Treasury arising out of subsection (e) of said section 13b or any agreement thereunder.

Sec. 2. Amendment of section 13 of the Federal Reserve Act.

Section 13 of the Federal Reserve Act, as amended, is hereby further amended by adding at the end thereof the following new paragraph:

"Subject to such limitations, restrictions and regulations as the Board of Governors of the Federal Reserve System may prescribe, any Federal Reserve Bank may guarantee any financing institution against loss of principal or interest on, or may make a commitment to purchase and thereafter purchase from a financing institution, any loan made to a business enterprise which has a maturity of not more than 10 years. No Federal Reserve Bank under this paragraph shall guarantee or make a commitment to purchase more than 90 per cent of the unpaid balance of any loan. The aggregate amount of guarantees and commitments of the Federal Reserve Banks under this paragraph outstanding at any one time, together with the amount of loans acquired thereunder and held by them at the same time, shall not exceed the combined surplus of the Federal Reserve Banks at such time; and the aggregate amount of such guarantees and commitments outstanding at any one time and loans held at the same time, which individually are in excess of \$100,000, shall not exceed 50 per cent of the combined surplus of the Federal Reserve Banks at such time."

STATEMENT IN CONNECTION WITH PROPOSED BILL
TO REPEAL SECTION 13b AND AMEND SECTION 13 OF THE
FEDERAL RESERVE ACT

The Board of Governors of the Federal Reserve System recommends for the favorable consideration of the Committee on Banking and Currency the attached draft of a bill which has for its purpose the revision of the authority of the Federal Reserve Banks to guarantee financing institutions against loss on loans made to business enterprises. Such guarantees by the Reserve Banks would require no appropriations by Congress.

The Federal Reserve Banks are especially qualified for providing financial assistance to business enterprises through commercial banking channels. They hold the reserves of member banks, they provide discounting facilities for member banks, they collect their checks, and they administer many of the governmental regulations affecting banks. In numerous ways the Reserve Banks have long been in close contact with commercial banks and business enterprises in their districts and are fully acquainted with their problems. Since the Federal Reserve Banks are permanent institutions with experienced personnel, the Board feels that whatever financial assistance is to be provided under governmental authority for business enterprises through commercial banks should be extended by the Reserve Banks.

During the war, the Federal Reserve Banks gained valuable experience in the administration of the V- and T-loan programs for guaranteeing war production and contract termination loans. Under those programs, the Reserve Banks, as of September 30, 1946, had processed 8,771 guarantees, aggregating nearly 10-1/2 billion dollars, losses being relatively small and substantially less than the guarantee fees collected. The proposed bill follows the guarantee principle which was applied under those programs; and financing institutions are already familiar with the services of the Reserve Banks in that field. Accordingly, the bill would not involve the establishment of any new governmental agency or the application of untried principles.

Even though business and credit conditions at any particular time may not be such as to require extensive use of the guarantee authority which the Reserve Banks would have under this bill, it is desirable that such authority be made a part of the law in order that it may be promptly available in periods when conditions are such that the need may be greater.

Provisions of the Bill

The proposed bill contains two sections. The first section would repeal section 13b of the Federal Reserve Act which contains the present authority of the Federal Reserve Banks to make and guarantee industrial loans. In doing so, it would require the return by the

Federal Reserve Banks of all funds heretofore received by them from the Treasury in connection with their industrial loan operations and would eliminate any further claim upon the Treasury for any part of the \$139,000,000 which was appropriated for this purpose. The second section of the bill would add a new paragraph to section 13 of the Federal Reserve Act in order to continue the authority of the Federal Reserve Banks to guarantee financing institutions against loss on loans made to business enterprises or to make commitments to purchase such loans, but on a more effective basis than at present. In carrying out operations under such authority, the Federal Reserve Banks would utilize their own funds and no use of Treasury funds or any appropriation by Congress would be required.

It will be recalled that when section 13b of the Federal Reserve Act was enacted in 1934, about 139 million dollars was appropriated out of the miscellaneous receipts created by the increment resulting from the reduction in the weight of the gold dollar, in order that the Secretary of the Treasury might make advances to the Reserve Banks for the purposes of industrial loans. About 27 million dollars has been received by the Reserve Banks from the Treasury under this authority. Under the proposed bill, the funds received would be returned to the Treasury and the appropriation would be repealed. Thus, 139 million dollars would no longer be earmarked for payment to the Reserve Banks and would therefore be available for other governmental purposes.

Revision of Existing Authority of Reserve Banks

The Board recommends the repeal of section 13b of the Federal Reserve Act because that section contains restrictive provisions which seriously impair the authority of the Federal Reserve Banks to lend the assistance to business which it is believed the Act was intended to provide. These restrictions require that loans be made for working capital purposes, that they be made only to established enterprises, that they have maturities of five years or less, and that the portion of the loan guaranteed may not exceed 80 per cent. When section 13b was added to the Federal Reserve Act in 1934, the need was very largely for working capital financing. However, experience has shown that many of the loans applied for involved the use of the proceeds for both working capital purposes and the acquisition of fixed assets and the repairing and modernizing of plants.

In lieu of the restricted authority contained in the present law, the second section of the proposed bill would authorize the Federal Reserve Banks to guarantee loans made by financing institutions to business enterprises. This authority would be subject to appropriate limitations. No loan guaranteed could have a maturity of more than ten years. While the percentage of the loan guaranteed by a Federal Reserve Bank would vary with specific cases, it could not exceed 90 per cent in any instance; in other words, the commercial bank would be required to assume at least 10 per cent of the risk involved in any loan. The

aggregate amount of all guarantees and commitments could not exceed the combined surplus of the Federal Reserve Banks; and, in order to insure the availability of guarantees for loans to smaller businesses, the aggregate amount of all guarantees which are individually in excess of \$100,000 could not exceed 50 per cent of the combined surplus of the Reserve Banks. All operations of the Federal Reserve Banks under this section would be subject to the regulatory supervision of the Board of Governors.

Direct Lending Eliminated

Authority for the making of direct loans by the Federal Reserve Banks, now contained in section 13b of the Federal Reserve Act, would be eliminated under this bill. The basic purpose of the proposed legislation is to assure an adequate flow of private credit to small businesses in times of need. The Federal Reserve Banks would not be placed in competition with the private banking system. Under the bill, the loans would be made by local banks dealing with local people whom they know and with whose character, capability and capacity they would be familiar. To the extent that the banks might make such loans without reliance upon a guarantee, so much the better. However, if for any reason the local bank should desire a guarantee, the support of the Federal Reserve Bank would be promptly available in suitable cases without the necessity of referring the matter to any agency in Washington for approval.

The Board feels strongly that any governmental assistance in the financing of small business should be extended by means of guarantees through the regular banking channels in the manner provided by this bill rather than through direct loans by governmental agencies. Moreover, under this bill the Federal Reserve Banks, which are permanent institutions, would use their own funds, rather than funds derived from taxation or governmental borrowing, for the purpose of aiding in the financing of business enterprises, and there would appear to be no necessity or justification for permitting any agency of the Government to use governmental funds for this purpose.