

**FEDERAL RESERVE ASSISTANCE  
IN FINANCING SMALL BUSINESS**

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*War Dept. letter page 18*

**HEARING  
BEFORE THE  
COMMITTEE ON BANKING AND CURRENCY  
UNITED STATES SENATE**

**EIGHTIETH CONGRESS**

**FIRST SESSION**

**ON**

**S. 408**

**A BILL TO REPEAL SECTION 13B OF THE FEDERAL  
RESERVE ACT, TO AMEND SECTION 13 OF THE  
SAID ACT, AND FOR OTHER PURPOSES**

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**APRIL 17, 1947**

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**Printed for the use of the Committee on Banking and Currency**



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# FEDERAL RESERVE ASSISTANCE IN FINANCING SMALL BUSINESS

THURSDAY, APRIL 17, 1947

UNITED STATES SENATE,  
COMMITTEE ON BANKING AND CURRENCY,  
*Washington, D. C.*

The committee met at 9:30 a. m., pursuant to call, in room 312, Senate Office Building, Senator Charles W. Tobey (chairman) presiding.

Present: Senators Tobey (chairman), Buck, Flanders, Cain, Maybank, Taylor, and Sparkman.

The CHAIRMAN. The committee will please come to order.

We are meeting today to consider S. 408, a bill to repeal section 13b of the Federal Reserve Act, to amend section 13 of the said act, and for other purposes. At this point the text of S. 408 will be placed in the record.

(The bill under consideration, S. 408, is as follows:)

[S. 408, 80th Cong., 1st sess.]

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,*

## REPEAL OF SECTION 13B OF THE FEDERAL RESERVE ACT

SECTION 1. Section 13b of the Federal Reserve Act is hereby repealed; but such repeal shall not affect the power of any Federal Reserve bank to carry out, or to protect its interest under, any agreement heretofore made in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 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.

## AMENDMENT OF SECTION 13 OF THE FEDERAL RESERVE ACT

SEC. 2. 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 ten years. No Federal Reserve Bank under this paragraph shall guarantee or make a commitment to purchase more than 90 per centum of

the unpaid balance of any loan. The aggregate amount of guaranties 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 guaranties 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 centum of the combined surplus of the Federal Reserve banks at such time."

The CHAIRMAN. I will now read a statement which I read at the time the bill was introduced by me.

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 guaranties, aggregating nearly 10½ billion dollars, losses being relatively small and substantially less than the guaranty fees collected. The proposed bill follows the guaranty 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 guaranty 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 5 years or less, and that the portion of the loan guaranteed may not exceed 80 percent. 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 10 years. While the percentage of the loan guaranteed by a Federal Reserve bank would vary with specific cases, it could not exceed 90 percent in any instance; in other words, the commercial bank would be required to assume at least 10 percent of the risk involved in any loan. The aggregate amount of all guaranties and commitments could not exceed the combined surplus of the Federal Reserve banks; and, in order to insure the availability of guaranties for loans to smaller businesses, the aggregate amount of all guaranties which are individually in excess of \$100,000 could not exceed 50 percent 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 13 (b) 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 guaranty, so much the better. However, if for any reason the local banks should desire a guaranty, 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 guaranties 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.

Mr. Eccles, before you read your statement, I am going to offer in evidence some communications which have come from different people with reference to this bill. One of these is a letter from the Department of Commerce, which is sent in response to the letter requesting the views of the Department on S. 408, and is signed by William C. Foster, Acting Secretary of Commerce.

Another is a letter from the Secretary of the Treasury, Hon. John W. Snyder.

The third is a letter from Hon. John D. Goodloe, recently elected Chairman of the Reconstruction Finance Corporation.

I will ask Mr. Hill to read these communications. Will you read first the letter from the Treasury Department?

Mr. HILL (the clerk). Yes, sir.

TREASURY DEPARTMENT,  
Washington, March 21, 1947.

HON. CHARLES W. TOBEY,  
*Chairman, Committee on Banking and Currency,  
United States Senate, Washington, D. C.*

MY DEAR MR. CHAIRMAN: Reference is made to your request for the views of this Department on two bills, S. 217, "To make credit available to small business enterprise and to continue the Reconstruction Finance Corporation for the purpose of effectuating a policy of credit assistance to competitive small business enterprise" and S. 408, "To repeal section 13b of the Federal Reserve Act, to amend section 13 of the said act, and for other purposes." You have also requested the views of the Comptroller of the Currency on the former bill and this will serve as a reply to that request.

S. 217 would extend the life of the Reconstruction Finance Corporation for a period of 5 years and the title of the bill would indicate that the extension is intended to be for the primary purpose of effectuating a policy of credit assistance to competitive small business enterprise. In that connection, I would like to state that the Department feels that the extension of credit by the Reconstruction

Finance Corporation to small business is desirable when it can be shown that their legitimate credit needs are not being met by private enterprise. The Corporation has such authority at present under its general lending powers and has been making such loans. This is evidenced by the statement of the President in his budget message of January 3, 1947, to the effect that the Corporation in its peacetime business loan program has been authorizing about 1,000 loans a month, chiefly to small business. The Department favors a continuance of that authority for legitimate credit needs.

However, it would appear that section 6 of the bill would continue the Reconstruction Finance Corporation not only for making loans to small business but would also continue all the present statutory powers of the Corporation. That is, section 6 would appear to provide for a blanket continuation of the Corporation and its powers. In that regard, the President in his budget message stated that a new charter for the Corporation to be submitted will provide for the repeal of all powers not required for peacetime activities. This Department is in accord with the position that the life of the Corporation should be extended but that powers of the Corporation not required for peacetime activities should be eliminated. Also, it would seem that the authority to make loans to small business should be considered in connection with the general extension of the lending powers of the Corporation rather than individually.

Section 1 of S. 408 would repeal section 13b of the Federal Reserve Act which set aside the gold increment fund for making advances to Federal Reserve banks for industrial loans. The repeal of that section would be in accord with the recommendation of the President in his budget message and would release to the Treasury the funds reserved for that purpose.

Section 2 of S. 408 would authorize Federal Reserve banks to guarantee loans made by financial institutions and to make commitments to purchase loans from such institutions, if the loans have a maturity of not more than 10 years. Such guaranties or commitments could not be in an amount more than 90 percent of the unpaid balance of the loan and the aggregate amount of guaranties and commitments would be limited to the combined surplus of the Federal Reserve Banks. Individual loans over \$100,000 could not exceed 50 percent of the combined surplus of the banks. You are advised that this Department would interpose no objection to granting such authority to the Federal Reserve banks. However, your committee may wish to consider the question of whether this authority might not in some measure cause some duplication in the field of authority of the Reconstruction Finance Corporation to make loans, assuming that such authority of the Corporation is continued.

In view of the hearing which you are holding on March 25 on S. 217 and in view of your request for expedition of our report on this bill, it has not been possible to secure the usual clearance from the Bureau of the Budget.

Very truly yours,

JOHN W. SNYDER,  
*Secretary of the Treasury.*

The CHAIRMAN. Now read the letter from Mr. Foster, Acting Secretary of Commerce.

Mr. HILL (the clerk). Yes, sir.

THE SECRETARY OF COMMERCE,  
*Washington 25, March 25, 1947.*

HON. CHARLES W. TOBEY,  
*Chairman, Committee on Banking and Currency,  
United States Senate, Washington, D. C.*

DEAR MR. CHAIRMAN: This is in response to your letter dated February 4, 1947, requesting the views and comments of this Department on S. 408, a bill to repeal section 13b of the Federal Reserve Act, to amend section 13 of the said act, and for other purposes.

S. 408 provides a sound basis for the expansion of much-needed small business credit facilities (the need for which I have also discussed in my comment on S. 217). We endorse the approach taken toward this problem in S. 408 because it recognizes the proper role of privately owned financial institutions in this field by providing for private participation in credit risks, by contemplating guaranties rather than outright loans by the Government, and by involving the commitment of private Federal Reserve funds rather than funds derived from taxes or public borrowing.

Despite the obvious purpose of S. 408 to improve credit facilities for small business, S. 408 contains no statement of any small business objectives except

to the limited extent they might be implied from the requirement that the aggregate amount of commitments which individually are in excess of \$100,000 shall not exceed 50 percent of the combined surplus of the Federal Reserve banks. Particularly in view of the clear statement of small business and antimonopoly objectives contained in S. 217 and certain other proposals for small business credit, it may be desirable to strengthen S. 408 along these lines, without, however, going so far as to write in standards which would compromise effective administration of the act or tend to preserve inefficient or uneconomic enterprise. One possible improvement along this line might be to specify that "the Board of Governors of the Federal Reserve System and the several Federal Reserve banks shall exercise their respective powers and duties under this act in such manner as may be necessary and desirable to discourage monopolistic practices and to strengthen and preserve the competitive position of small business concerns in an economy of free enterprise."

In addition, the committee may wish to consider the desirability of reinforcing the small business aspects of this legislation by prescribing specific lending standards to be applicable to each loan considered for guaranty or purchase. In this latter connection, you may be interested to know that the Small Business Advisory Committee of this Department, in preparing a draft of a proposed amendment of section 13, suggested the inclusion of explicit terms and conditions concerning such matters as (a) interest rates and other terms comparable to those available to large concerns, (b) the extension of a loan only in any case where the loan represents a substantial portion of total capital requirements, (c) sufficient term of years, (d) flexible amortization dependent, at least in part, upon profits, (e) optional advance repayment of interest and principal, (f) reasonable limitations upon withdrawal of sums for payment of salaries or dividends to owners, (g) sufficient regard for short-term requirements of the borrower, (h) sufficient regard for character of the borrower. It is recognized, of course, that these matters can be taken care of by rules and regulations of the Board of Governors of the Federal Reserve System, and in some cases merely by the application of sound and progressive banking principles. It is also recognized that such limitations and conditions must be carefully framed and considered if sound administration of legislation of this character is not to be compromised. On the other hand, in view of the fact that these points have been raised by persons very actively interested in promoting the competitive position of small business, it is believed that such provisions should be given careful consideration on their merits, and that provisions of this character need not be detrimental to sound banking practice. In short, although the efficacy of this legislation lies ultimately in the character of its administration, the inclusion of some appropriate standards of this character may increase public confidence in this bill as a measure for the preservation and strengthening of small business, may provide appropriate guidance to those who will have operational responsibilities under the legislation (including private banking establishments), and may therefore minimize the risk of public pressure for credit legislation of unsound character.

We believe that the committee should give special attention to the fixing of a reasonable maximum interest rate which takes full account of the principle that any savings resulting from the pooling of risks should be passed along to the borrower to the fullest extent feasible, and which recognizes that the guaranty provided by this legislation is virtually tantamount, as a practical matter, to a guaranty by the Government. We have discussed this matter at greater length in our letter concerning S. 217, in which we stated that we did not consider unreasonable the 4-percent rate mentioned in that bill.

In addition, although we feel strongly that legislation of this character should provide credit assistance by extending guaranties, or through an insurance or participation system, rather than by outright loans, and although we seriously question the need for authorization which would permit such outright loans, we think it would be appropriate for the committee at least to inquire whether S. 408 should be amended to permit outright loans under exceptional circumstances, particularly in view of the fact that S. 217 and other small business credit proposals provide for such loans, and since it may therefore be presumed that there will be considerable popular pressure for statutory authorization of this character at some future time if not immediately. If it is deemed necessary to provide for outright loans by the Government, however, the statute should make it clear that such loans should be given under only exceptional circumstances, and then only up to a fixed percentage of the guaranties or of the funds available for commitment. In the Small Business Advisory Committee proposal mentioned above, for example, a provision for outright loans was set forth as follows:

"(e) When it appears to the satisfaction of a Federal Reserve bank, under exceptional circumstances, that a newly organized or established small business enterprise has been unable to obtain financial assistance on reasonable terms from any financing institution, such Federal Reserve bank may participate in or make commitments respecting loans to, make loans to, or purchase obligations of, such small business enterprise under the conditions set forth in subsection (a) of this section, provided that the total amount of all such participations, loans, and purchases in excess of \$250,000 per borrower shall not exceed 25 percent of the resources made available for this purpose under subsection (c) of this section."

Although we doubt the necessity or desirability for such a provision, we think that it deserves careful consideration. If you desire any further comment or assistance in regard to this matter, do not hesitate to call upon us.

I have not been advised by the Bureau of the Budget as to the relationship of this bill or this report to the program of the President.

Sincerely yours,

WILLIAM C. FOSTER,  
*Acting Secretary of Commerce.*

(The following was received for the record:)

THE UNDER SECRETARY OF COMMERCE,  
*Washington, April 17, 1947.*

HON. CHARLES W. TOBEY,  
*Chairman, Committee on Banking and Currency,  
United States Senate, Washington, D. C.*

DEAR MR. CHAIRMAN: I regret very much that a previous commitment to testify at a hearing relating to Inland Waterways Corporation, one of the agencies in this Department, precluded my complying with your request to appear before your committee this morning regarding S. 408.

Pursuant to Mr. Hill's request, however, I am sending to you, herewith, several copies of the statement which I had anticipated making at the hearing which was originally scheduled for yesterday morning. For your convenient reference and for possible inclusion in the record on S. 408, I am also attaching two copies of my letter of March 25, 1947, concerning S. 217, and the statement which I made on March 25, 1947, in the course of your hearings on S. 217.

As noted in these papers, none of our communications regarding either of these bills had been cleared with the Bureau of the Budget.

Sincerely yours,

WILLIAM C. FOSTER,  
*Under Secretary of Commerce.*

STATEMENT OF UNDER SECRETARY OF COMMERCE WILLIAM C. FOSTER, BEFORE  
THE SENATE COMMITTEE ON BANKING AND CURRENCY, CONCERNING S. 408

Mr. Chairman, as I pointed out at greater length in my testimony and letter concerning S. 217, as well as in my letter concerning S. 408, there is ample evidence of the need for improvement of the credit facilities available to small business. In view of the fact that my previous statements were prepared with both bills in mind, I shall not endeavor to dwell upon the character of this need or to discuss all the details covered in these letters. Rather, I shall merely summarize the essential respects in which we consider S. 408 to be a preferable instrumentality for the extension of small business credit, and endeavor to answer such questions as you may care to raise.

As we pointed out in our letter of March 25, 1947, concerning S. 217, it is our feeling, in general, that the provisions of a measure of this character should be predicated upon the policy that privately owned banks and privately owned capital undertake the entire burden of providing adequate financing for small business to the fullest extent feasible, and that Government aid or sponsorship should be extended only if privately owned banks and other private financial institutions fail to provide such financing. While much of the action necessary for the improvement of small business credit facilities can be taken by the banking fraternity itself, some legislative action is undoubtedly necessary, particularly if small business credit facilities are to be improved in the immediate future. It is important, however, that such legislation recognize the primary responsibility of the privately owned institutions, on a basis which will encourage the private institutions themselves to take affirmative steps to improve these facilities. It is our belief that S. 408 meets these requirements more fully than S. 217 by providing for a division of risk between the Government and private lenders, by utilizing exclusively a system of guaranties and purchase commitments which

make the private financial institution the primary lending agency in each case, and by committing private rather than public funds to back up the guaranties which are contemplated.

In our letter concerning S. 408, we indicated several matters which we believe to deserve special consideration by the committee. These relate primarily to making the small business purposes of the bill more explicit, by writing into it specific small business and antimonopoly objectives and standards. We recognize that the efficacy of this legislation lies ultimately in the character of its administration, but the inclusion of some appropriate standards of this character, of a nature which will not compromise effective and economical administration, may increase public confidence in this bill as a measure for the preservation and strengthening of small business, may provide appropriate guides to those who will have operational responsibilities under the legislation (including private banking establishments), and may therefore minimize the risk of public pressure for credit legislation of unsound character.

I have not been advised by the Bureau of the Budget as to the relationship of this bill or this statement to the program of the President.

The CHAIRMAN. I will begin to read a letter from Hon. John Goodloe of the R. F. C.

This bill would repeal section 13 (b) of the Federal Reserve Act, require a return to the Treasury of the aggregate amount which the Secretary of the Treasury has heretofore paid into the Federal Reserve banks under the provisions of section 13 (b), and authorize the Federal Reserve banks to guarantee any financing institution against losses up to 90 percent on loans, with maturities of not more than 10 years, made to business enterprises. The guaranties and commitments outstanding at any one time would not exceed the combined surplus of the Federal Reserve banks.

Whether Federal Reserve banks should guarantee risk loans made by member banks we believe is dependent on the answers to the following:

(1) Is the proposal in keeping with the original concept of the purposes of the Federal Reserve Act?

(2) Is the proposal in keeping with fundamentally sound banking practices and principles?

(3) Would the adoption of the proposal result in supplying the risk credit needed by business?

It is the purpose of this report to present certain considerations which are involved in these questions, the answers to which may have far-reaching effects on our banking structure and the total economy of the country.

At the present time the banks of the country are as strong as they have ever been in history and they must be maintained on the soundest basis which can be devised. The commitment by Federal Reserve banks, whose capital and surplus in relation to their liabilities at the present time amount to only about 1 percent, to guarantee loans on the basis provided in the bill raises, we believe, a serious question as to the effect the assumption of such risks will have on our present banking structure. Obviously, during periods of high productivity, the assumption of such risks would not in and of itself be immediately dangerous, but in a period of national financial crisis might well contribute to another economic collapse.

Proponents of the bill state that the Federal Reserve banks would utilize their own funds and that no use of Treasury funds or any appropriation by the Congress would be required. While technically this view can be supported, nevertheless in the event of losses it would be necessary, obviously, to draw on reserves.

The second paragraph of section 7 of the Federal Reserve Act, as amended, provides as follows:

"The net earnings derived by the United States from Federal Reserve banks shall, in the discretion of the Secretary, be used to supplement the gold reserve held against outstanding United States notes, or shall be applied to the reduction of the outstanding bonded indebtedness of the United States under regulations to be prescribed by the Secretary of the Treasury. Should a Federal Reserve bank be dissolved or go into liquidation, any surplus remaining, after the payment of all debts, dividend requirements as hereinbefore provided, and the par value of the stock, shall be paid to and become the property of the United States and shall be similarly applied."

This provision would seem to raise serious doubt that the surplus funds in question belong to the Federal Reserve banks. While it is true these funds do not constitute Treasury funds and are not appropriated, they nevertheless appear to be funds in which the United States has a direct interest.

In view of Federal Reserve's experience to date under section 13b, it is not unreasonable to question, in the event restrictions in existing power are removed, whether loans would be made in sufficient number to meet the credit requirements of borrowers unable to obtain credit through normal banking channels. Under the present section 13b, the Reserve banks may lend money to provide funds for working capital, such loans to have maturities of 5 years or less. While admittedly the restrictions referred to are important, nevertheless the power granted by the section has been exercised only to a moderate degree. In fact, as of December 31, 1946, only a little more than one-half million dollars was outstanding under that section, involving only two Federal Reserve banks. In view of this experience to date under section 13b, your committee, in passing on the merits of S. 408, may wish to explore the extent to which the authority contained in that bill is likely to be exercised.

Assuming, however, that the authority would be exercised to the limit, the amount made available under S. 408 would be inadequate. During the year 1946 alone, which was one of high production and prosperity, the Reconstruction Finance Corporation made loans aggregating approximately \$445,000,000 to business enterprises which could not secure credit from usual banking channels. On the other hand, if we could assume that authority were to be exercised to the limit, the business risks which would be assumed by the Federal Reserve banks are far greater than those ever assumed by the RFC. Business enterprise loans may be made by the RFC only to solvent businesses and must be so secured as reasonably to assure repayment. S. 408 makes no provision whatever for security and contains no requirement as to solvency. The losses which might result are difficult to anticipate. Certainly, however, the minimum of losses which may reasonably be expected under S. 408 would be greater than the percentage sustained to date under section 13b, which requires loans to be made "on a reasonable and sound basis."

Finally, the entry of the Federal Reserve banks into this field of direct risk lending represents a departure from the traditional concept of their purposes and functions, which, as stated in the report on H. R. 7837, later enacted into the Federal Reserve Act, are:

"1. Establishment of a more nearly uniform rate of discount throughout the United States, and thereby the furnishing of a certain kind of preventive against overexpansion of credit which should be similar in all parts of the country.

"2. General economy of reserves in order that such reserves might be held ready for use in protecting the banks of any section of the country and for enabling them to go on meeting their obligations instead of suspending payments, as so often in the past.

"3. Furnishing of an elastic currency by the abolition of the existing bond-secured note issue in whole or in part and the substitution of a freely issued and adequately protected system of bank notes which should be available to all institutions which had the proper class of paper for presentation.

"4. Management and commercial use of the funds of the Government which are now isolated in the Treasury and subtreasuries in large amounts.

"5. General supervision of the banking business and furnishing of stringent and careful oversight.

"6. Creation of market for commercial paper. Other objects are sought, incidentally, in these plans, but they are not as basic as the chief purposes thus enumerated" (p. 11, H. Rept. No. 69, 63d Cong., 1st sess.).

The Bureau of the Budget advises that they have no objection to the submission of this report.

Sincerely yours,

JOHN D. GOODLOE.

The CHAIRMAN. Now we can take this up seriatim unless you have any objection, but the first crack out of the box I raise this question: He says that S. 408 makes no provision whatsoever for security—I am addressing Mr. Eccles—he says that S. 408 makes no provision whatever for security and contains no requirements for solvency.

Is my understanding correct that you only loan to the banks themselves, whose first function is to pass on solvency and credit—is that correct?

Mr. ECCLES. That is correct.

The CHAIRMAN: So that applies to some extent to that argument. I only spoke of that because it stood out like a sore thumb to me. Now, Mr. Eccles, we will hear from you.

**STATEMENT OF MARRINER S. ECCLES, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM**

Mr. ECCLES. Mr. Chairman, Senator, members of the committee, I have a statement here that is not very long, and I would like to read it because I think it might save time and will be a basis for questioning if questions should arise.

I should like after reading the statement and after questions with reference to the statement, or after the Senators may be through interrogating me with reference to the statement, if time permits, to make some observations with reference particularly to the RFC's comments upon the bill.

I am glad to have an opportunity to appear here this morning in order to urge the passage of S. 408.

The bill has two sections. The first one repeals section 13b of the Federal Reserve Act and provides for the return to the Treasury of approximately \$139,000,000 that was set aside from the gold increment to enable Federal Reserve banks to make direct loans to industrial and commercial businesses. The second section of the bill substitutes for the direct lending authority a provision which would enable Federal Reserve banks to guarantee in part loans by chartered banks, particularly to small and medium-size businesses that need capital for periods up to 10 years.

It is important to emphasize that the principal purpose of the bill is to make term loans especially to smaller businesses for the purpose of providing them with necessary capital that they could not otherwise obtain. It will fill a gap in private financing that now exists in enabling these enterprises to obtain essential financing. The costs of going to the capital markets for small business are prohibitive. Likewise, many banks properly feel that they cannot extend some term credits for from 5 to 10 years without some protection as provided by this bill. It amounts to a form of spreading the risk by providing insurance for a fee. It is not the purpose of this bill, however, to provide guaranties for either short- or long-term financing which banks can and should extend without assistance.

The basic need of the smaller, independently owned business enterprises is for long-term funds. Some businesses need funds for modernization of plant and equipment and additional facilities. The need also arises from the sharp increase in prices and greatly expanded volume of business resulting in a much larger volume of accounts receivable and of inventories. Because of these various factors, many enterprises whose financing needs have ordinarily been met through current borrowings now need a funding of their short-term obligations into a term loan.

Owners of small enterprises, as a rule, prefer to obtain funds on a loan rather than on an equity basis because they do not wish their stock ownership to be diluted or to run the risk of losing control of the business. Term loans amortized out of profits meet this need. This type of financing is particularly suitable for small businesses that need a substantial period of time to retire loans by gradual repayment from earnings.

There has been considerable objection from some of the larger banks to S. 408 on the ground that the smaller banks, which are the correspondents of the larger banks, in cases where the amount of the loan was beyond the legal limit of the smaller banks, would resort to the guaranty even though the loan was of such quality that it could be made without the guaranty by giving participations to their correspondent banks or other banks in the community. In order to meet this objection, the Board recommends that the committee adopt the suggestion of the Federal Advisory Council of the Federal Reserve System which, as you probably know, is a body of 12 bankers from the 12 Federal Reserve districts, elected to advise with the Board and to represent the banking fraternity of their district.

The CHAIRMAN. Do they ever radically differ with the Board? Does history record any radical difference?

Mr. ECCLES. Yes. I think there have been some substantial differences.

The CHAIRMAN. Did they ever dominate the Board?

Mr. ECCLES. I do not think so. I hope not.

The CHAIRMAN. Did they ever think the Board was mistaken and that their policy was superior?

Mr. ECCLES. Of course I could not very—

The CHAIRMAN. Are they anything more than accessories after the fact?

Mr. ECCLES. I could not very well admit that having happened while I have been there, but it may have happened before that time.

The CHAIRMAN. Let us put it very badly. Are they anything more than a group of good fellows who see eye to eye with the Federal Reserve Board 95 to 100 percent of the time?

Mr. ECCLES. I would not say they always see eye to eye. They have been, and I think can be, extremely useful if they are objective and if the Board is objective and if there is a good relationship existing, because they do come from the country and the Board can get at least the point of view of the bankers, and particularly the larger bankers from their areas. They are elected by the Board of Directors of the Reserve banks.

Senator BUCK. One from each bank?

Mr. ECCLES. One from each bank. So that they bring into the Board advisory information.

The CHAIRMAN. A fresh viewpoint from the hinterland, is that it?

Mr. ECCLES. That is right. In addition to that we find this also to be true: They very often will come in with one side of the picture and when they also hear the Board's side and the Board's reasons and the Board's arguments, very often we find that there is a modification of their views and they take back to the country—

The CHAIRMAN. A more intelligent and informed opinion?

Mr. ECCLES. I think so; yes; and I think that it is helpful to the Board to have them go back to the country and advise them the Board's point of view.

Now we will take as an example this direct-purchase bill that certain economists, and some few bankers, and some Senators have been opposed to.

Now, here is a council that were unanimously in favor of that bill.

The CHAIRMAN. Do you keep records, minutes, of their gatherings?

Mr. ECCLES. Oh, yes; we do. They come in and they spend the day—we submit questions to them for their advice, and they also will submit questions that they want to ask us and they are all put on the agenda, maybe a month before the quarterly meeting, and every member of the Council has an opportunity to put questions to each member of the Board and these questions are submitted for discussion.

The Council gets into Washington usually on a Sunday. They spend a full day in discussing this and the law requires that the Board make available to them any and all information that it has.

Senator BUCK. How often does it meet?

Mr. ECCLES. Four times a year under the statute, but the Executive Committee of the Council which is composed five members, meets every month except in the summertime.

Mr. Ned Brown of Chicago is an extremely able person and an extremely objective person. He is the Chairman of that Council.

Mr. Charlie Spencer of Boston is the Vice Chairman of the Council.

Mr. Robert V. Fleming, president of the Riggs Bank, Washington, D. C., represents the fifth district at Richmond.

So you see, we have some outstanding very able men on that Council.

As I say, they are unanimously in favor of that bill and I am quite sure that it was because of the very fact that they had been on the Council, some of them for a number of years, and they were thoroughly familiar with the open market committee operations, the Federal Reserve operations. They saw this from possibly a different angle than would have been possible had they been merely sitting out in their bank and hearing one side of the argument.

In the case of this particular legislation, this Council, composed of these men, are favorable to S. 408, and I am sure if you knew these men you would not consider that this could be such a dangerous thing as Mr. Goodloe seems to think it would be for the Federal Reserve System. No one would accuse Andy Burgess of recommending a dangerous procedure by way of the use of guaranties or credits.

Senator BUCK. It seems to me it is a much preferable procedure than to allow the RFC to make these loans.

Mr. ECCLES. Thank you, Senator. I cannot help but agree with you on that matter.

Senator BUCK. I know that, although I have not heard the rest of the testimony.

The CHAIRMAN. What you started to say was, "Do not make me laugh, my lip is cracked," did you not?

Senator BUCK. I have an idea the chairman feels the same way about it as I do.

The CHAIRMAN. I think he does. Go ahead, Mr. Eccles.

Mr. ECCLES. These amendments that the Council proposed, suggested, we are recommending that they be adopted:

When it appears to the satisfaction of such Federal Reserve bank—  
it does not say Board, it says Federal Reserve bank—

that the business enterprise is unable to obtain requisite financial assistance on a reasonable basis from the usual sources.

That would prevent the guaranteeing of credits that were perfectly good and able to get elsewhere, and where the guaranty was primarily to enable the local bank to carry an excess loan rather than sell a participation in that loan to its city correspondent or to a bank of the community, that they use a guaranty.

Now, the guaranty is not for the purpose of merely enabling banks to get excess credits, such as I think was done under the blanket provision the RFC had in effect for a considerable time and which they discontinued in January because of the very strong opposition throughout the banking fraternity.

Now, I am proposing that amendment in the bill at the recommendation or suggestion of the Council. The Board also favors the recommendation of the Federal Advisory Council that the bill be amended to provide that the guaranty be restricted to "chartered banking institutions" only and not to "any financing institution" as provided in the bill.

As a practical matter I would say that 99 percent of the business would be done by charter banking institutions, even though it said any financial institution in the bill.

Senator BUCK. What do you mean by charter banks? Member banks?

Mr. ECCLES. No, a charter bank. That is any charter bank. Most of them are State nonmember banks that are chartered.

Senator BUCK. What kind of bank is it that is not chartered? I want to understand what you mean. You mean incorporated, do you not?

Mr. ECCLES. That is right. Any financial institution of course could mean—well, building and loan companies, or a great many types of institutions that are not set up for the purpose of necessarily financing business enterprise, and the Federal Reserve System does not have a direct relationship with those, and it was felt that Federal Reserve certainly should not make this program available except through the chartered banks.

That would cover not only all member banks but it would cover all State banks which are not member banks.

Senator BUCK. You are suggesting an amendment of this section 2?

Mr. ECCLES. That is right. This was suggested by the Council. The Council recommends the bill as it is, with the exception of the two amendments which we have accepted—the Board has accepted in the System—and we recommend the bill be amended to include the two amendments that were proposed by the Federal Advisory Council and those are the two now that they are proposing.

I do not think this second one, "chartered banking institutions"—it is really more academic than it is real, but we have no feeling about it, and they prefer it so we are recommending it, but we have no strong feeling about it certainly. We would just as soon leave it as it is because as I say, 99.9 percent of the business will be done by the banks anyway.

It should be borne in mind that the Reserve System has had the authority under 13b for the past 13 years to make direct loans or to make commitments to purchase loans made by private banks. On principle, we feel that the private banks should originate and make the loans based on their credit judgment, and that neither the Federal Reserve banks nor any other governmental agency should extend such credits directly.

Senator BUCK. On what position would you purchase the loan from the private bank?

Mr. ECCLES. Would we purchase it?

Senator BUCK. Yes. Under what conditions?

Mr. ECCLES. Well, we will have to make regulations by the Board but we find—

Senator BUCK. I mean under the present act.

Mr. ECCLES. We have made lots of direct loans under the present act.

Senator BUCK. I do not mean loans.

Mr. ECCLES. And lots of participations under the present act.

Senator BUCK. But you have the right to purchase under this section from the—

Mr. ECCLES. We purchase upon the demand of the bank.

Senator BUCK. Why do they demand?

Mr. ECCLES. They do not as a practical matter. There have not been any purchases. The principle is if they should require it to—

Senator BUCK. But you never have done it?

Mr. ECCLES. No. The fact is the banks want the loan.

Senator BUCK. If the loans were not any good why would they ask you to take them?

Mr. ECCLES. The point is, you have to take the loss anyway. We may want to take the loan to protect the insurance, you see.

Senator BUCK. But these are not insured?

Mr. ECCLES. What is it?

Senator BUCK. These loans under 13b are not insured?

Mr. ECCLES. That is right. They are not insured but you guarantee them. Under 13b, the loan that is made by a Reserve bank directly, of course, it is their money and they run the loan. The loan that is made by the private bank, in which we agree to purchase the loan by the private bank, or the portion of it that we agree to purchase. You see there is a participation; there have been three things done under 13b.

First, the Reserve System makes direct loans without regard to the bank.

Second, the Reserve System will make maybe 60 or 70 or 20 percent of the loan and the banks may carry the rest of it.

Thirdly, the banks may make a loan directly and get a commitment from the Reserve bank to purchase that loan up to a total which they could not purchase, up to a total of 80 percent. That would be the maximum amount that they could take, which in effect is a guaranty—the fact that you agree to purchase the loan upon request. The banks, of course, do not call upon the Reserve System is purchase that loan unless the loan is in difficulty and the Reserve bank may want to take it in any case to work it out or make arrangements with the bank to keep the loan and work it out and reimburse them for the Reserve proportion of the loss when it develops.

Senator BUCK. One more question if I might.

Why would a borrower come to the Federal Reserve bank for a substantial loan rather than a commercial bank?

Mr. ECCLES. Well, of course, they cannot under this bill.

Senator BUCK. They can under 13b.

Mr. ECCLES. That is right. Well, during the time that was put in in 1934 the banking system was just not making loans hardly of any kind. The kind of loans that were needed then and the kind that were being made by the Federal Reserve bank today would be made by the private banks.

At that time, the private banks were not making credit available very readily. You will recall the——

Senator BUCK. You do not entice them there by any enticement of a better interest rate?

Mr. ECCLES. No. The Federal Reserve banks have never gone out and solicited. They have never had any blanket arrangements such as the RFC had. We have never gone out and tried to get loans. The only loans that they made are loans that came into the bank voluntarily, and even then I do not think there is a case where the Reserve banks have made the loans without finding out who the banker was of the concern that came in; and most of the loans that came in, came in as a result of the bankers sending the borrower to the Reserve bank, and if they came in directly the Reserve banks have always checked with the banker to find out whether or not he would not take a participation.

I know of a good number of cases where the Reserve banks have taken the matter up with the banker and gotten the banker to consider the credit and maybe make it or at least gotten the banker to take a participation in the credit.

The Reserve banks have tried to keep away as far as they could from competition with the private bankers and have done everything to help secure the loan or as much of it as possible outside.

Senator BUCK. That has always been my understanding.

Mr. ECCLES. In this case here the Reserve banks, of course, could not—no one would go to them in the first instance because they cannot make a direct loan. The loans must come through the chartered bank. That is where they must originate. They must come through the chartered bank, and they would come into the Reserve banks for the guaranty. And the Reserve banks would guarantee such portion as they felt they should guarantee. If they felt it was a loan that should not be guaranteed, that should be placed without the guaranty, and that is was merely being offered because it was an excess loan, they would ask the bank to go to their correspondent bank or the bank in the community to participate in the credit.

On the other hand, if it was a type of loan that could not be placed without the guaranty, and still look like a reasonable long-term credit, the Reserve bank would exercise—or would grant the guaranty, as I will bring out—maybe I better finish this statement.

I think most of this is answered. Section 13b moreover, is not adapted to present-day needs. It limits the extension of credit to loans for working capital only and provides that loans cannot be made for more than 5 years and can be made only to established businesses.

The proposed bill does not call for Government appropriations, and therefore no drain on the Federal budget is involved. The Reserve banks would use their surplus funds as a basis for the guaranties, and should losses be sustained they would first come out of the fund created by the guaranty fees charged. If this were not adequate, losses would be met out of the Reserve banks' net earnings or surplus. I am sure that this responsibility placed on the officers and directors of the Reserve banks, under regulations and supervision of the Board of Governors, will not encourage easy and unsound credits on the part of the private banks.

Under section 13b Federal Reserve banks handled some 3,500 applications for commitments and advances, aggregating about 560

million dollars. Similarly, under the V-loan program, 8,771 authorizations for guaranties of war production loans, aggregating nearly 10.5 billion dollars, were handled. The interest and fees collected in connection with this total of about 11 billion dollars of operations were more than sufficient in both programs—this is not just a combination—but more than sufficient in both programs—to cover expenses and losses and to show some profit. In other words, the record is not one of-loose lending.

At this time I want to read a letter we just got in that connection from Kenneth Royall. I would like to put it in the record if I do not have time to read it in connection with this V-loan program from the Army that was handled. This bill, of course, does not place the Reserve banks in competition with the private banking system. Credit judgment and responsibility would remain primarily with the lending bank. Loans guaranteed would originate with local banks dealing with local people whom they know and with whose character, capability, and capacity they would be familiar. A Federal Reserve bank could not guarantee any loan unless requested to do so by the local bank. If approved by the Reserve bank the guaranty would be made promptly available without referring the matter to any agency—or, I might say, the Board—in Washington.

Each loan would have to be passed upon by the Federal Reserve bank. There would be no blanket approval. The 12 Federal Reserve banks and their 24 branches provide a regional organization through which local financing institutions in all parts of the country would have convenient access to a guaranteeing agency if needed. The Federal Reserve System, which is a permanent organization created by Congress and responsible to Congress, is especially qualified to provide this service because of its close contacts and daily relationships with banking institutions. Its responsibilities for maintaining sound credit conditions, so far as its powers permit, make it the appropriate agency for this purpose.

As in the case of war-production loans under the V-loan program, a maximum interest rate would be set for guaranteed loans. The present maximum rate under section 13b is 5 percent, and it is contemplated that the initial maximum rate under the new legislation would be the same. Within this limit—that is a limit only—which may be subject to change with changing conditions, interest rates would be determined by the borrower and his bank. Competition would help to determine that.

Under the V program there were a lot of loans at 2½ percent. Guaranty fees charged would be a specified percentage of the interest rate, graduated according to the percentage of the loan guaranteed.

As an example, if it were a 90-percent guaranty, the bank carrying 10, which is the minimum the bank could carry, and we will say the rate was 4 percent, the guaranty fee, we will say, was 25 percent. That would mean 1 percent of that interest charge of 4 percent would have to be paid as a guaranty fee and would leave the bank with a 3-percent net on the 90-percent portion and 4 percent on the 10-percent portion.

Now, if the bank carried 70 percent, the guaranty fee may well be only 10 percent of the interest charge, inducing the bank to carry the largest possible part unguaranteed, because the rate of guaranty would be that much less. The guaranty fee charged would be a specified percentage of the interest rate, and so forth.

The method would be similar to that used in the V-loan program, when guaranty fees ranged from 10 to 30 percent of the interest rate—we had up to 95 percent guaranty under the V-program and it was 30 percent of the rate that was charged—according to the percentage of the guaranty. This has been, and would be, the operating procedure.

It is evident, therefore, that the lending banks must carry some portion of the loans without guaranty, and this will be a deterrent on their making undesirable and risky loans. The steeply graduated guaranty fees will induce banks to carry as much of the risks as possible and thus cause them to exercise careful judgment and prudence in passing upon credits.

Business and credit conditions at present and at some other times may not be such as to require extensive use of the guaranty authority. However, the Reserve banks should have a stand-by service of this kind to render to business and industry when necessary. The amount of long-term funds that individual enterprises may need is often relatively small.

As I said in the beginning, a 5- to a 10-year term loan is what is needed by most small businesses because they have no access to the capital market as the big ones.

The CHAIRMAN. Are those loans predicated upon an amortization feature?

Mr. ECCLES. Yes, definitely.

The CHAIRMAN. Is that in the bill?

Mr. ECCLES. No; it is not.

The CHAIRMAN. Is that an administrative matter?

Mr. ECCLES. Yes.

The CHAIRMAN. Have you given any assurance that that would be the policy?

Mr. ECCLES. I am certain the local banks would not make them on any other basis, and I am sure if they did the Reserve banks would guarantee them, and I am sure if there was any further check, that the Board would not permit—would require it in the regulations. Many loan demands do not exceed \$10,000 and relatively few exceed \$100,000. The bill is intended and designed primarily to help the smaller enterprises. The larger ones, as a rule, do not need this sort of assistance because they can go to the capital market and raise funds either by bonds or equity financing.

The guaranty service, as provided in this bill, would be available in the future, as it has in the past, without discrimination for all banks, whether members of the Federal Reserve System or not.

It would be ill-advised and short-sighted, in my opinion, for Congress to repeal section 13b in order that the \$139,000,000 of Government funds thereunder may be returned to the Treasury and fail to provide this proposed alternative authority to the Federal Reserve banks. The proposal is the result of long and extensive experience which the Federal Reserve System has had in connection with the loan-guaranty principle. It is a tried and tested principle exemplified in Federal Housing Administration loans as well as in loans to veterans. This bill is a means of aiding the private banking system of this country to meet particularly the longer term financing needs of the smaller business institutions without assuming excessive risks.

Now, I would like to read—talking about experience—a letter that we received on March 26 from the War Department. It is addressed to myself as Chairman of the Board of Governors.

DEAR MR. ECCLES: On this anniversary of Executive Order 9112—  
which is the order under which the Board operated—

which was signed by the President on March 26, 1942, I desire to express to you personally, and through you to the members of the Board of Governors of the Federal Reserve System and to the officers of the Federal Reserve banks, the deep appreciation of the War Department for the very great assistance which the entire System has rendered it in connection with the guaranteed loan program.

The underlying philosophy of the Executive order was, as you know, that in assisting war production contractors through guaranteed loans the War Department should use not only the funds already in the commercial banks of the country, but should utilize the existing credit machinery as well. It was to that end that the Federal Reserve banks were appointed the fiscal agents of the War Department.

The universal acceptance of the principle of regulation V-loans by both the contractors and the banks is due in no small part to the good judgment, the skill, and the expedition with which they have been handled by the Federal Reserve banks. Especially appreciated were the helpful suggestions of the Reserve banks during the liquidation phase of the V and T programs which, in many respects, called for an even greater degree of financial management than that required in the initial extension of credit.

You and the members of the Federal Reserve System who participated in this program should feel a deep satisfaction in your contribution to this important part of the war effort.

I wanted to read that because it is recognition of the work that the System did in connection with the guaranteeing of loans.

The CHAIRMAN. Now, Mr. Eccles, thank you.

For the benefit of those Senators who came in since you began to read your statement I have caused to be read into the record a statement from Mr. Snyder, Secretary of the Treasury, Mr. Goodloe, of the RFC, and Mr. Foster, of the Department of Commerce, prior to his reading his statement. They are all in the record.

Senator BUCK. Mr. Chairman, may I ask the Governor one question?

The CHAIRMAN. Mr. Buck:

Senator BUCK. I am not certain as to the purpose of the amendment.

Let us see if I am correct. The bank has an opportunity to make a loan which is too large for the organization, and they might try to hog it all and take it to your bank, the Red Fall Reserve, rather splitting up with other—

Mr. ECCLES. That is what they have been doing under the RFC blanket provision.

Senator BUCK. This amendment will prohibit that.

Mr. ECCLES. In other words, the Reserve bank would be expected under this provision to refuse to guarantee a loan which was good without the guaranty, merely guaranteeing it for the purpose of enabling the bank, where its limit was \$10,000, to carry \$50,000 because the guaranty part you see is not subject to the limit.

In other words, the bank is limited to 10 percent, if they are a national bank, of their capital surplus, on the ordinary loan. On a guaranteed loan of this sort, the limit would not apply and therefore a bank may well say:

We will loan \$50,000. We can carry 10 of that but we cannot carry the other 40 without the guaranty. We will therefore go to the Reserve System, instead of giving participation in this credit to the other banks.

Senator CAIN. Now, they must participate?

Mr. ECCLES. Now, the other banks would participate in the credit, unless it was a type of credit that was entirely unsatisfactory. In other words, this is not to be used for the purpose of enabling the banks to carry excess loans. It is to be used for the purpose of guaranteeing credits that otherwise cannot be secured. That is the point we want to make.

The CHAIRMAN. On page 1 of your statement, the third paragraph, the concluding sentence is:

It amounts to a form of spreading the risk by providing insurance for a fee. It is not the purpose of this bill, however, to provide guaranties for either short- or long-term financing which banks can and should extend without assistance.

I point out, in amplification of that, that this is not something that the banks would come and lay down their demand upon you. It is a rule of reason between the Federal Reserve and the individual banks.

Mr. ECCLES. That is right.

The CHAIRMAN. The banks are looked at, and the conference is held, and the values are appraised, and then if they are given the green light, O. K., that is right.

Mr. ECCLES. The credit would originate with the local bank and their customer. The local bank would consider the credit, and it is particularly the term loan where banks are needing more capital, as I stated in this statement here, because of higher prices, because of expansion, they are short of capital, and they cannot go to the capital market, small banks cannot, it is prohibitive, and they want to retain control of the business—it is in a small group maybe, a family, or a small group, and what they need is a long-term credit. That is what they want.

This would enable the local bank to say:

All right, we are willing to take 20 percent without any guaranty. It looks perfectly good to us, but we do not feel that a 10-year loan, a frozen type of credit—we do not want to carry it without some protection or insurance.

We saw that work in the Federal Housing, that a long-term mortgage loan on an amortized basis, it was impossible before you had FHA to get an 80 or 90 percent mortgage on a home over a long period of time.

With the insurance program it is possible, and under the V program the fees charged on the insurance not only took care and paid for all expenses, and all losses, but left a substantial profit.

The CHAIRMAN. Now, a national bank in Chicago we will say, has a request for a loan come to it, looks it over, approves the loan and says:

We will take this loan provided we can pass it on to the Federal Reserve bank under S. 408. They have made an application for credit, reviewed the credit, and given consideration to the factors

and then they come to the Federal Reserve bank and say:

Here is one of the loans we want to take under S. 408.

Mr. ECCLES. Then the Reserve bank goes over it very carefully to determine whether or not it is a proper loan, it is in the public interest it is a good thing for the business.

The CHAIRMAN. You have got two straining points?

Mr. ECCLES. That is right. The Federal Reserve merely provides the guaranty for a fee.

The CHAIRMAN. Up to 90 percent for a fee?

Mr. ECCLES. That is right. If you go to 90 percent the fee is pretty high. The inducement would naturally be for the bank to carry as much as it safely could because the fee is that much less.

Senator CAIN. If it is a good loan you do not put up any money?

Mr. ECCLES. It is the loss and the fees. We would expect and hope that the fees charged would take care of the losses. However, if they do not, it would have to come out of Federal Reserve bank earnings and surplus, but we do not think, based on experience, that that is likely to happen, but if—

The CHAIRMAN. Is it customary for national banks ever to make a service charge or commission charge for negotiating a loan in addition to the interest on the loan?

Mr. ECCLES. They could not under this guaranty.

The CHAIRMAN. I know but has that ever been customary?

Mr. ECCLES. Yes. They have made commitment fees which is proper. I would say that they may come along and say:

All right, we will underwrite a credit of half a million dollars.

The concern may not be sure they are going to need it, but they want to call on us, so the bank will say: "All right, we will underwrite it" and they will charge what they call a commitment fee.

The CHAIRMAN. What does that generally consist of?

Mr. ECCLES. That is what they negotiate with the borrower. It may be a quarter percent, 1 percent, three-quarters.

The CHAIRMAN. Could the banks do that in this case here, where the burden is taken off of the Federal Reserve?

Mr. ECCLES. They could not charge in the aggregate more than 5 percent interest.

The CHAIRMAN. They could not charge any service fee here?

Mr. ECCLES. No. You could not beat the interest by putting some 2 percent or 3 or some special fee on it.

The CHAIRMAN. That is what I am getting at.

Mr. ECCLES. If we put a 5-percent maximum rate—and I say that—now a 5-percent rate for a very small loan is not an excessive rate, because the work in connection with making the loan, the work in connection with the supervision in following the loan, over a long period of time, a large loan may be cheaper to handle at 2½ percent than a small loan at 5.

Now, we do not want to get the rate down to the point where the bank says, "Well, I am not interested in the loan. The rate is so low I am just not interested in it." And due to our experience under V and T we have found that a 5-percent ceiling, and then let the competitive situation take care of it, that if the credit is such that the banks want it, with the guaranty, as we have experienced, the credit has got down to 2½ percent in the V-program.

Some of the large credits in the V-program got down to 2½ percent because of the competition for the credit, with the insurance.

The CHAIRMAN. Now, gentlemen of the Senate, Mr. Eccles is ready to answer any questions.

Senator CAIN. May I ask Mr. Eccles one question?

Just a brief observation, Mr. Eccles. Personally I see great virtue in this bill. I am a little bit concerned—perhaps unnecessarily—about the fact that it is going to be permanent legislation. Have you given

any thought as to an experimental period, let us say 5 or 10 years, at which time you or your Board would come back before the Congress to explain how well the operation had been carried out and then we would consider the future from that point?

Mr. ECCLES. As an agent of Congress we would of course every year report the operations.

Senator CAIN. Oh, indeed.

Mr. ECCLES. And Congress could at any time repeal.

Senator CAIN. Well, Congress could.

Mr. ECCLES. And they likely would if the results were not satisfactory. We feel that this should be made a permanent part of the legislation—the Federal Reserve statute—because, in the first place, conditions change economically, and I would think at the present time there is not anywhere near the use or need for it maybe that there may be at other times. Certainly in an inflationary period there may well be much greater use than there may be in a deflationary period. They have great responsibility to try and maintain credit conditions so far as they can within their authority. That is one of their functions, and this we feel is a necessary adjunct to enable them and assist them to help maintain sound credit conditions.

Senator CAIN. I know that, but would you have any particular objection to a provision being in the bill that these amendments will be made to have an income for a period of 5 or 10 years. Would that upset your plans or your program?

Mr. ECCLES. No. We would prefer not to have it, but rather than not have the bill at all we would certainly prefer to have the limitation, and within a period of time—

Senator CAIN. I would like to see the limitation. I do not conceive that it would do the Federal Reserve System any harm, and it would definitely make certain that the entire operation was looked at again rather keenly within a reasonable period of time from now.

It would cause you some trouble to come and go into this business, but it would bring it very forcefully to the attention of this particular committee, for example. I think your method of proposed operation is better than what you have been doing in the past.

Mr. ECCLES. Of course, I would say that is entirely the—we are the creatures of Congress. We are an agency that reports to the Congress. We are an independent agency which reports to the Congress, and certainly it seems to me that it would be presumptuous for us to question the judgment of this committee, or a committee of the House that this would come before, with reference to a matter of that sort, that if the Congress feels that there should be a limitation, and that it would better enable them to carry out their responsibility—

Senator CAIN. That is just one Senator's point of view, Mr. Eccles.

Mr. ECCLES. Yes. Well, I am merely saying I would not make much of a point of that. I would prefer not to have it, but I would not make much of a point of it.

The CHAIRMAN. Any further questions?

Mr. Sparkman?

Senator SPARKMAN. Mr. Eccles, I notice that the aggregate of all guaranties does not exceed the combined surplus of the Federal Reserve banks. How much is that now?

Mr. ECCLES. About \$440,000,000.

Senator SPARKMAN. And then of the large loans, \$100,000 or more would be limited to half of that?

Mr. ECCLES. That is right.

The CHAIRMAN. Is that surplus increased by increasing regularly down through the years?

Mr. ECCLES. Is it what?

The CHAIRMAN. Is it in steady rise down through the years, that surplus?

Mr. ECCLES. Yes, and then we turned back to the Government \$139,000,000. We turned \$139,000,000 which is the capital of Federal Insurance Corporation on which I understand a bill has been introduced, and we recommend it, proposing to retire the \$139,000,000 of stock owned by the Federal Reserve System.

The CHAIRMAN. That is Senator Capchert's bill.

Mr. ECCLES. And that that money be turned back to the Treasury, so that that will give the Treasury \$139,000,000 which was in the surplus of the Reserve banks and which we got stock for. That would go into the Government.

Now, this \$139,000,000 here is \$139,000,000 which was that portion of the gold profit. When they devalued the gold it was that portion of it which was set aside to be used as a guaranty fund for the present 13b operation.

We are now proposing that that \$139,000,000 be turned back to the Government, and that the 13b section of the bill which is entirely inadequate to meet the present situation, be repealed, but in the process of repealing that and turning this over to the Government we are suggesting this other amendment giving us this particular power that is called for—is the second section in 408.

The CHAIRMAN. It is a kind of an unusual feeling to have something turned back to the Government in contradistinction to the reverse?

Mr. ECCLES. Out of the Reserve banks' earnings, which is very substantial now above their expenses, the Board is considering—we have the authority under what is known as section 16 of the Federal Reserve Act, to put an interest charge or a tax on Federal Reserve notes in circulation which are not secured by gold. That portion which is not covered by gold certificates we can levy the tax upon them, and we are considering levying a tax upon the notes of each bank in an amount that would turn into the Government each quarter the excess earnings of the Reserve banks, possibly 90 percent of them.

Now, that should turn into the Government each year, from that source, based upon the present earnings of the banks in excess of expenses, somewhere between 60 and 75 million dollars. That may well increase, should there be an increase in the short-term rate, in the bill rate.

The CHAIRMAN. What percentage of those notes are without gold now?

Mr. ECCLES. Somewhere between 50 and 60 percent.

The CHAIRMAN. How much gold have we at Fort Knox now?

Mr. ECCLES. We have got a total amount of gold in the country between 20 and 21 billion dollars, as I recall it.

The CHAIRMAN. What is it doing?

Mr. ECCLES. It is held as security back of gold certificates.

The CHAIRMAN. Is it in the back of your mind, or has it ever occurred to you, the suggestion that gold ought to be revalued on a rising scale?

Mr. ECCLES. I would certainly be very much opposed to any such a program. There would be not the slightest justification for it.

The CHAIRMAN. It has been suggested.

Mr. ECCLES. It would certainly be inflationary in its implications, and it would merely mean that the foreign gold throughout the world would sell to us at that much more and we would be merely turning that many more dollars to the gold producers throughout the world without getting anything but more gold to put in storage, and it would seem to me to be an entirely unjustified procedure.

In connection with this section 16 authority, on turning this money back to the Government, we can do it. That formerly was turned back on what was known as the franchise tax. That franchise tax was repealed in 1933. I do not know why but it was repealed. I suppose it was when the surplus went below the—because of the \$139,000,000 being taken out, would reduce the surplus and they repealed that so that the surplus could be built up.

Now, the Board is considering getting the money back through this section 16, this special tax on notes. If the Congress would prefer to reimpose the franchise tax and get it back that way, they can, but that will take legislation and we can accomplish the same purpose through the application of the tax.

I mentioned this to the House committee in a hearing on the direct purchase authority, and I am merely mentioning it here today as what we are intending to do, which would mean of course, if the Congress has objection to getting the money back by that method they can get it back by some other method, but it seems to me that they are interested more in the end result of having earnings of a Reserve bank which after all the Government has the residual interest in, being turned back to the Government.

Senator BUCK. What has become of the gold coins which were in circulation about 15 years ago? Have they been melted down or are they still retained as gold coins?

Mr. ECCLES. I think most of it is still in gold coins.

The CHAIRMAN. That \$20 gold piece is the handsomest coin ever minted.

Mr. ECCLES. It is.

The CHAIRMAN. I would like to see one again.

Mr. ECCLES. I would like to, Senator, if I may, make a reference to the RFC's statement here.

The CHAIRMAN. Be temperate in your remarks, I admonish you, sir.

Mr. ECCLES. Mr. Goodloe, by the use of facts but not the use of all of the facts, has created a very erroneous and a very false impression. We know that sometimes the truth half told is inclined to—

Senator BUCK. What statement do you refer to?

Mr. ECCLES. The one that was just read in the record this morning. The opposition.

Senator BUCK. I was not here.

Mr. ECCLES. I would like to answer some of those. I have not time to answer them all, but I would like to refer to one or two of them, and then I would like the privilege of putting into the record a more complete answer.

The CHAIRMAN. I think that reference you made a few minutes ago, about a lie that is half a lie, comes from Tennyson's poem *The Grandmother*, which elucidated that principle very strongly.

Sometime when you are going to bed, look it up.

Senator MAYBANK. Does Mr. Eccles have reference to those 6 months that Mr. Goodloe enumerated at the end?

Mr. ECCLES. Yes. That is what I had reference to. I will not have time to go into all of them. I feel I would like to write the letter, but I would like to point out, in the first place, that he makes this point: That it is a very unsound thing for the Federal Reserve to do this sort of guaranteeing.

Senator MAYBANK. Mr. Chairman, might I ask another question?

The CHAIRMAN. Yes, indeed.

Senator MAYBANK. Are you going to expand at all on this second statement of Mr. Goodloe? As I remember, in my mind, it was the second statement, in connection with the—

Senator CAIN. Losses?

Senator MAYBANK. No. It is the one in there, Senator, that has to do with the Federal Reserve being so liquid as to protect the banks throughout the country.

Mr. ECCLES. That is right. I want to cover that.

Senator MAYBANK. That was the one that interested me the most in connection with this bill because I remember the bank holiday so well and that was the only place anybody could go.

Mr. ECCLES. That is right. I would like to point out in the first place that there is practically no limit to the power of the central bank to create money.

How do you think the war was financed to the extent that it was, and that the growth of bank deposits was over 300 percent?

Now, that would only have been made possible by the operation of the central bank. Why do you think the interest rate on the public debt has remained just as it has? The central bank has the power of issue. It is sovereign. It is a sovereign power of government in the central bank, and the idea of the Federal Reserve System being looked upon as a private institution, which Mr. Goodloe's approach is one of looking at the central bank as though it were a private institution.

Now, the Federal Reserve System—he refers to the ratio of its assets to its liabilities—I mean its capital and surplus to its liabilities—that the liabilities are very great in relation to its capital surplus. I would like to point out that he overlooks the fact that this is a central bank and not a private bank, and that the assets that it has against the—I should say the liabilities that it has against its surplus, you must take the assets it also has—in the first place practically its sole assets are Government bonds and gold certificates.

Now, those are its assets, you see, and such currency and coins and so forth. Almost its entire assets is money or the equivalent.

Now, it does have some loans to member banks. Those loans are secured, almost in their entirety, by Government securities. There is little likelihood that banks borrowing on bills payable from the Federal Reserve System will borrow on anything but governments because there is a favorable rate, and it is very convenient to borrow on the governments, and therefore because banks have governments, that is what they will likely borrow upon, and there are practically no banks but what have at least from 40 to 60 percent of their total assets are governments.

Therefore, if they had occasion to borrow they will borrow on governments or they will sell governments to the Reserve bank.

Now, that is the asset side. What are the liabilities? The liabilities are not the liabilities of an ordinary commercial bank. The liabilities are the deposits of banks, but those deposits are not subject to withdrawal. Those deposits are legally required reserves, almost entirely—there are some that are not, of foreign banks, small amounts—but the great bulk of the deposit liability of the Federal Reserve banks are required reserves of the member banks and are not subject to withdrawal.

The other liabilities are Federal Reserve notes which make up practically 90 percent of our currency. That is the other liability. The Federal Reserve notes are secured in their entirety by gold certificates and Government bonds and are guaranteed by the United States.

Now, I mention that as one indication of a false impression that has been given in this statement which is not based upon the facts. The central banks generally not only have—central banks generally have the function of loaning. The Bank of France, the bank of almost any South American or European country, and the Bank of Canada, either through a subsidiary, or directly, loan, not only to banks such as the central bank does, but loan directly to industry, and have done so for years, so that it is not an unusual provision at all.

Now, with reference to the risk, in the first place the guaranty risk that would be taken by the Reserve bank is not a dangerous risk. It is not dangerous because in the first instance the local bank must take a participation. The local bank is not likely to take a participation in a credit that just is bad, and credits of that sort just shouldn't be made.

If a local bank will not take up to 10 or 15 or 20 percent in the credit—

Senator BUCK. You do not think he ought to be required to take 20 percent?

Mr. ECCLES. I think exceptions may be made. I think that the fact that the fee charge will induce them to take more will be a factor, and I think the Reserve banks—

Senator BUCK. Of course that provision the Reserve bank can stipulate too, can they not?

Mr. ECCLES. Oh, yes. The Reserve bank may require the bank to do it but at any rate you do have that check.

Secondly, I do not believe that the directors and the management of these Reserve banks, based upon the record that they have here, are going to incur, or going to make a lot of extremely dangerous and loose credits at all. I believe that you can certainly rely upon the management and the directors of these Reserve banks to use good judgment. Their record in the past, with the large volume of guaranteed credit that they made, which exceeds \$10,000,000,000, is an indication of the experience they have had and of the way the matter will be handled.

Now, then, there is the fee mind you—of course there are going to be losses—you cannot go into this thing without some losses—but you have got to remember that there is a fee here that would go into a fund to help absorb those losses. If the losses exceed—

The CHAIRMAN. Is that built up as a reserve, this suspense account for losses?

Mr. ECCLES. Oh, yes, and if that fund—what FHA has under their mortgage scheme is the same thing—and if that fee is not sufficient

to pay the losses then the earnings of the Reserve banks of course would be used toward that end and Mr. Goodloe is correct in this portion of his statement, that the Government does have a residual interest in the Reserve banks and that to the extent that the earnings of the Reserve banks would have to be used to sustain losses there would be that much less that the Reserve banks would be able to pay over to the Government only.

The CHAIRMAN. The International Bank has a similar provision if you remember, of building up a reserve for losses.

Mr. ECCLES. That is right. They have a fund for that very purpose.

Now, I just wanted to point that aspect of the problem out. Now, in addition to that, Mr. Goodloe points out that this is entirely contrary to the conception of the Reserve System, and he quotes from a statement in the House committee report. As a matter of fact, he only quotes a portion of it—he only takes—

The CHAIRMAN. I could not help this, but was that report in the House committee, that phase suggested by a Senator from Nebraska or from Ohio, by a Representative from Nebraska or Ohio, that part of it?

Mr. ECCLES. I really do not know. Carter Glass was chairman of the committee, and it was his report. I remember part of that. Parker Willis had something to do with writing that report. That was a very important factor. I would like to point out in the first place that the history of the Federal Reserve Act and its sole purpose was not to help banks as such but its purpose was to help commerce, agriculture, and industry, that was its basic purpose.

The purpose was to see that the credit was provided. What this is undertaking to do is intended to help the banks to provide that credit. It is not providing it directly. It is helping to provide it indirectly but it is participating, we will say, with the banks in the risk.

Since the original Federal Reserve Act was passed, and its conception was as expressed in Mr. Goodloe's letter, there have been some very basic changes through amendments. That concept—and even though what we are doing is not even contrary to that concept—however, that concept has been very greatly changed and modified because that concept was based upon the operation of the gold standard, upon the free gold payment, upon gold redemption. That is what it was based upon.

You have no gold redemption today. It was based upon the currency of the banks being secured by gold or commercial paper. Today you have no commercial paper in the Reserve banks, and the provision of the law is Government securities. So that the quotation taken from the report of the committee is only a section of the statement, and it does not take into account the entire history of it, nor does it take into account the basic amendments that have been made since the Federal Reserve Act was passed.

Now, as to the sufficiency of this credit of \$400,000,000, which is the limit of the amount that can be guaranteed, I believe that that amount of credit is certainly sufficient if it is confined to those credits, to not be otherwise secured, and it should be made.

Now, of course, if it is going to be used as the RFC used last year their blanket operation, in which the banks could make the loan, and

the RFC did not approve of it at all, it was approved by the bank under a blanket guaranty, and the banks made a great many loans that could have been made without the guaranty because they could carry the excess portion of the credit.

Now, I would admit, if we were going to have any such blanket-guaranty arrangement, and this was going to be used as a means of enabling banks to carry excess loans, that it would not be sufficient, but for the purpose for which it is intended to be used I am sure it is ample, and if it is not ample, then we can come to the Congress and we can ask for further authority, we can ask for appropriations, we can ask for whatever the situation seems to call for, but certainly, for the time being, this seems to be and should be entirely adequate.

Senator CAIN. What is the greatest number of dollars you have ever had outstanding under 13b, approximately?

Mr. ECCLES. Actually \$60,000,000 was the total amount of the actual dollars but, in addition to that, of course, there were the commitments to the banks—I think probably around that time about \$30,000,000.

The CHAIRMAN. Senator, if I may interpolate, our friends are here from the Export-Import Bank, Mr. William McChesney Martin, President, and his counsel, Mr. Hawthorne Arey. I agreed with them that I would let them go on at 11:15. It is now 11:25. If you have any concluding remarks I would be glad to give you a few more minutes.

Senator SPARKMAN. I have a short question.

Do I understand that the \$139,000,000 is separate and apart from the \$440,000,000 reserve or is it a part of that?

Mr. ECCLES. The \$139,000,000 is separate. It is money that has never been—

Senator SPARKMAN. It is earmarked for a definite purpose.

Mr. ECCLES. It is earmarked in the Treasury. It has never been taken into the Reserve System nor has it been taken into the funds of the Treasury. It is a gold profit that is set aside, and it would now become Federal revenue; it would be other revenue, and it would add to the receipts of the Treasury \$139,000,000, and it would not be taken out of the Reserve System, because it has never been in either the Reserve System nor in the Treasury.

I recognize that last year the RFC made—as indicated by Mr. Goodloe—four-hundred-and-seven-odd-million dollars of credits, loans, and guaranties. It would seem to me that, last year being a year of very great inflationary activity, that the economy may have been very much better off without that much additional credit pumped in, that that large volume of credit made by the RFC was due to a blanket agreement which has now been repealed and which the banks objected to very seriously, because it enabled banks to go out and make the guaranty first without first clearing it with the RFC, and it enabled the banks likewise to make excess loans that should not have required any Government guaranty whatsoever.

If I may, Mr. Chairman, submit for the record a written report on this—I have not had an opportunity to answer fully and completely either Mr. Goodloe's letter or the commerce letter and I would like to be able to do that rather than off the cuff, which you must admit is not—

The CHAIRMAN. We would like to have you submit it so it will be clear to whoever reads it, in connection with the argument made here.

Mr. ECCLES. I want to thank you for this opportunity to present 408.

Senator BUCK. Mr. Chairman, if it is in order I move the approval of the two amendments recommended by the Federal Advisory Board and presented by Mr. Eccles.

The CHAIRMAN. There are only six here. I think we better wait until a quorum is present.

(Whereupon, at 11:25 a. m. the hearing was concluded.)

The following was later received for the record:

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,  
*Washington, April 25, 1947.*

HON. CHARLES W. TOBEY,  
*Chairman, Committee on Banking and Currency,  
United States Senate, Washington, D. C.*

MY DEAR MR. CHAIRMAN: During recent hearings before your committee on the bill S. 408, relating to guaranties of business loans by the Federal Reserve banks, there was read into the record a letter addressed to you by Mr. William C. Foster, Acting Secretary of Commerce, dated March 25, 1947, with respect to the merits of that bill.

The Board is pleased to note that Mr. Foster believes that this bill provides a sound basis for the expansion of much-needed small business credit facilities and that he endorses the approach to the problem represented by the bill. The letter suggests that the committee may wish to consider the desirability of including in the bill certain directives, with respect to which the Board would like to express its views.

Regarding the suggestion that consideration be given to the inclusion in the bill of specific lending standards, it is contemplated that limitations relating to interest rates, maturity, and other similar matters would be covered by regulations prescribed by the Board of Governors. The Board believes that the incorporation of specific or rigid requirements in the law itself would tend to impede the flexible administration of the bill. Experience has indicated that it is almost impossible to anticipate the detailed limitations which may be desirable in the future; and if the law should specifically prescribe lending requirements and standards it would doubtless be necessary at a later date to change or clarify them by amendments to the statute. In fact, it might be desirable in times of severe economic depression to have quite different conditions and limitations surrounding the guaranteeing of loans from those appropriate for times like the present.

The Commerce Department's letter expresses the view that special attention should be given to the fixing of a reasonable maximum interest rate and indicates that 4 percent would not be considered an unreasonable maximum. The Board feels that flexibility is desirable and that maximum interest rates should be left to be prescribed by regulations from time to time in the light of changing credit conditions and business needs. There may be instances in which a 4-percent rate of interest would not adequately compensate a lending bank for the supervision and servicing required in connection with a small loan; and the fixing of such a maximum rate might tend to make banks reluctant to extend credit in such cases and might consequently have the effect of defeating the objectives of the bill.

With respect to the suggestion that the bill S. 408 might include an express statement of small business or antimonopoly objectives, the Board feels that there would be no necessity for including this expressly in the light of the explicit purposes of the bill. Antimonopoly objectives have been stated in other statutes enacted by Congress; and the Federal Reserve banks and the Board of Governors, of course, would administer the bill in conformity with those objectives.

The letter also suggests that consideration might be given to an amendment which would permit direct loans under exceptional circumstances, but expresses doubt as to the necessity or desirability for such a provision. On principle, the Board feels strongly that private banks should originate and make loans to business enterprises and that legislation should not now provide for direct loans by the Federal Reserve banks or by any other governmental agency. Under the bill, the Reserve banks would not be placed in competition with the private banking system. They would be authorized to make only partial guaranties of loans and then only upon the request of a local bank. Credit judgment and responsibility would and should remain primarily with the lending banks which are fully acquainted with the character, capability, and capacity of their customers.

The Board is glad to have the Commerce Department's support for this bill. We have considered carefully the suggested amendments, and have concluded that the bill does not require additional safeguards and would be more workable and practical without further amendments.

Sincerely yours,

ERNEST G. DRAPER, *Chairman pro tempore.*

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,  
Washington, April 25, 1947.

HON. CHARLES W. TOBEY,  
*Chairman, Committee on Banking and Currency,  
United States Senate, Washington, D. C.*

MY DEAR MR. CHAIRMAN: When Chairman Eccles appeared before your committee on April 17, 1947, during hearings on the bill S. 408 relating to guaranties of business loans by the Federal Reserve banks, there was read into the record a letter addressed to you by Mr. John D. Goodloe, Chairman of the Reconstruction Finance Corporation, dated April 15, 1947, in which the enactment of that bill was opposed on various grounds. Chairman Eccles requested an opportunity to amplify what he said orally by submitting a letter to be incorporated in the hearings, and on behalf of the committee you accorded him this privilege. This letter is in accordance with that understanding.

Mr. Goodloe suggests that guaranties of business loans by the Federal Reserve banks on the basis provided in the bill would involve the application of unsound banking practices; and he refers to the fact that the ratio of capital and surplus of the Reserve banks to their liabilities at the present time amounts to only about 1 percent. This statement, however, ignores the fact that the Federal Reserve banks are central banking institutions and not commercial banks and that the relationship of their capital and surplus to their liabilities does not have the same significance as do similar ratios at private banks. Over 90 percent of the assets held by the Federal Reserve banks against their liabilities consists of gold certificates and obligations of the United States Government. Most of the rest of their assets are in the form of items in process of collection, cash, and loans to member banks secured by Government obligations. The deposit liabilities of the Reserve banks consist principally of the reserves of their member banks which under the law must be maintained with the Reserve banks and are not available for customary withdrawal. The principal remaining liabilities of the Reserve banks are represented by Federal Reserve notes which constitute obligations of the United States and are wholly secured by gold certificates and Government obligations. Thus, the capital and surplus of the Federal Reserve banks are entirely adequate when measured by their risk assets.

Even if the guaranty authority were used by the Reserve banks to the full extent permitted by the bill, it would not affect the discharge by the Reserve banks of their broader responsibilities in the monetary and credit field. There is nothing in the bill which would tend to bring about or contribute to a national financial crisis. Rather than contributing to an economic collapse, the authority provided in the bill would make it possible for small business concerns to obtain credit which would not otherwise be available to them.

On the second page of Mr. Goodloe's letter it is stated that the surplus funds of the Federal Reserve banks which would be used for the purposes of this bill are funds in which the United States has a direct interest. These surplus funds are the accumulated excess earnings of the Federal Reserve banks resulting from their operations, and the United States has the residual interest in such of these funds as remain after meeting the obligations of the Reserve banks in case they are dissolved or go into liquidation. Obviously, therefore, the use of these funds by the Federal Reserve banks as going concerns is quite different from the use of public funds derived from appropriations by Congress.

Mr. Goodloe's letter raises a further question as to whether the funds available under this bill would be adequate. It is the Board's belief that the maximum amount authorized by the bill would be sufficient to enable the Reserve banks to provide guaranties with respect to all the risk credit that will be needed within the near future. The bill is intended to provide the Federal Reserve banks with a stand-by authority to be used whenever the need may arise. If it should become apparent at any time in the future that the funds available are not sufficient to meet the need then existing, the permission of Congress for additional authority could, of course, be requested. In this connection, Mr. Goodloe cites

the fact that the Reconstruction Finance Corporation, during 1946, made loans aggregating approximately \$445,000,000 to business enterprises which could not secure credit through the usual banking channels. It is understood that the bulk of these loans was made under the Corporation's blanket participation agreement. In the Board's opinion, however, it is questionable whether there is any need for the guaranteeing of business loans in such large volume during periods of prosperity such as existed in 1946 or whether it is desirable that so much credit be created at a time of great inflationary activity. It is also open to question whether many of the loans made under the Corporation's blanket participation agreement would not have been made even if no guaranty had been available. The plan was unnecessary and has now been discontinued.

The suggestion is made in Mr. Goodloe's letter that the bill does not contain provisions which would adequately protect the Federal Reserve banks against loss. This suggestion overlooks several important considerations. It is contemplated that under the bill regulations would be prescribed by the Board of Governors which would contain provisions with respect to the soundness of loans guaranteed and the extent of the risk to be assumed. Such regulations, coupled with the fact that the Federal Reserve banks would utilize their own funds in making guaranties, would provide adequate protection against loss. Moreover, loans guaranteed under the bill would originate with local banks who would be fully acquainted with the character, financial ability, and solvency of their customers; and they would not be willing to make loans with or without a guaranty unless they had reason to expect their repayment.

Under the bill, lending banks obtaining guaranties would pay guaranty fees which would be steeply graduated according to the percentage of the loan carried by the lending bank. Consequently, banks would wish to carry as much of the loan as possible and would exercise careful judgment and prudence in passing upon credits.

Guaranty fees received under the bill would constitute a fund out of which any losses could be absorbed. Federal Reserve banks would, of course, be expected to incur some losses if they are to guarantee any large volume of loans, since the purpose of the legislation is to guarantee loans the quality of which is such that the banks would not make them without a partial guaranty. The fund accumulated from guaranty fees, however, should be adequate to cover such losses, and even if experience under the bill should be more unfavorable than now anticipated, it is believed that losses which could not be taken care of out of current earnings of the Federal Reserve banks would not amount to more than a relatively small portion of their surplus.

Finally, Mr. Goodloe's letter quotes an excerpt from the report of the House Banking and Currency Committee on the bill which became the Federal Reserve Act as indicating that the entry of the Federal Reserve banks into the field of direct risk lending would represent a departure from the traditional concept of their purposes and functions. It is believed, however, that there is nothing in the original or amended Federal Reserve Act which is inconsistent with guaranties of business loans by the Federal Reserve banks. Guaranties of such loans would be entirely in harmony with the authority conferred upon the Reserve banks by the original act to provide indirect assistance to business enterprises by the discount of commercial paper held by their member banks; the only difference is that in the one case a member bank bears only a part of the risk, while in the other case it is required to assume all of the risk.

In this connection, your attention is called to the fact that the report of the House committee on the original Federal Reserve Act, referred to by Mr. Goodloe, expressly stated that one of the fundamental elements of that legislation was the "creation of a joint mechanism for the extension of credit to banks which possess sound assets and which desire to liquidate them for the purpose of meeting legitimate commercial, agricultural, and industrial demands on the part of their clientele." Furthermore, the report of the Senate Banking and Currency Committee on the original Federal Reserve Act similarly stated that one of the chief purposes of that act was to "make available effective commercial credit for individuals engaged in manufacturing, in commerce, in finance, and in business to the extent of their just deserts."

The authority which would be conferred upon the Reserve banks by this bill is in keeping with powers customarily exercised by central banking institutions and in the Board's opinion is entirely in harmony with the basic concept of the functions of the Federal Reserve banks.

Sincerely yours,

ERNEST G. DRAPER, *Chairman pro tempore.*

MERCHANTS & PLANTERS BANK,  
Montevallo, Ala., April 21, 1947.

CHAIRMAN, BANKING AND CURRENCY COMMITTEE,  
Senate Chamber, Washington, D. C.

DEAR SIR: Before me is a letter or copy of a letter from Chairman Eccles in which he takes exceptions to a speech of Mr. Walter B. French. All of which has to do with bill S. 408.

I think Mr. French is definitely right in his thinking. The time has passed when Government and Government guaranteed lending should stop.

Your cooperation will be appreciated.

Sincerely yours,

J. P. KELLY, *Cashier.*

ASSOCIATE BANKERS OF ST. LOUIS,  
St. Louis, Mo., March 22, 1947.

HON. CHARLES W. TOBEY,  
Senator from New Hampshire, Senate Office Building,  
Washington, D. C.

DEAR SENATOR: The Associate Bankers of St. Louis (comprising 20 of the smaller banks located in the city of St. Louis) at a regular meeting of the association held on Thursday, March 20, at which all members were represented, discussed your proposed Senate bill S. 408 for the elimination of section 13B (concerning commercial loans and guaranties) of the Federal Reserve Act and the substitution of broader provisions and authorities.

Upon motion duly made and seconded, the association went on record as favoring your proposed bill S. 408 and I have been instructed to so advise you.

I have also been instructed to forward a copy of this letter to the two Senators from Missouri and to the Congressmen of our district.

Hoping that this bill will eventually be passed and with all good wishes, I am

Very sincerely yours,

EARL M. JOHNSTON, *Secretary.*

DUQUOIN, ILL., April 22, 1947.

HON. CHARLES W. TOBEY,  
Chairman, Senate Banking and Currency Committee,  
Senate Office Building, Washington, D. C.

DEAR SENATOR: I am informed that Senate bill 408 also known as the Tobey bill, is now pending in the Senate Banking and Currency Committee.

As I understand the bill, it will authorize the Federal Reserve banks to guarantee business loans initiated by any private financing institution. This would seem to fill the need for financing small businesses, particularly in cases where smaller banks are unable to make sound business loans, because they exceed the banks legal loaning limits. However, I believe that the bill should be amended to limit the guaranty provision to loans originated by chartered banks, rather than by "any financial institution." This need may not be so apparent under present business and credit conditions, but it is believed that some such arrangement should be provided now.

The Federal Reserve bank, which is a permanent organization and especially qualified to provide the service, because of its close contacts, and daily business relationship with banks, would appear to be the better governmental agency to handle this.

Enactment of this bill is recommended.

Yours truly,

F. MARK MILLER.

PEOPLES BANK OF CUMBERLAND,  
Cumberland, Md., April 21, 1947.

Senator C. W. TOBEY,  
Chairman, Senate Banking Committee,  
Senate Office Building, Washington, D. C.

HONORABLE SIR: As a country banker, I commend you for the magnificent proposal and bill you now have placed before Congress that will enable small business to secure loans from the banking system which is unquestionably the life blood of our economic structure.

It is with great interest that we notice that large city bankers have requested and insisted that the bill embrace a deference to forcing a participation with them, by the country banks to exhaust every effort to obtain financial aid for small business prior to an application to the Federal Reserve banks. This plan was proposed, inaugurated, and conducted under the leadership of Mr. Robert M. Hanes for the American Bankers Association during the past 4 years and has been a dismal, disappointing failure. Please remember that the need for small business capital usually arises quickly and must be served efficiently without delay. Our own experience has been that in 90 percent of small business loans which we, in our bank, have considered sound have been rejected when offered to our city bank correspondents for participation which has resulted in the denial of several small, profitable businesses in our own community because the legal loan limit was beyond that which we could serve. This, indeed, has served as a detriment to the economic well-being of our community and certainly must not be unlike other sections of our country.

In conclusion, we urge passage of this bill that will enable efficient and sound service to small business through banks by a plan that will not be fettered and restrained by large city banks that you may be assured that if the country banks are given the opportunity, they will serve small business effectively and unhesitatingly with the knowledge that risk capital extended to small business shall not be at the complete peril of our depositors.

We feel certain that the enactment of this legislation will immediately be responsive to a marked improvement in our national economic condition.

Respectfully yours,

H. R. FLETCHER, *President.*

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THE AMOSKEAG NATIONAL BANK,  
Manchester, N. H., March 28, 1947.

HON. CHARLES W. TOBEY,  
*United States Senate, Washington, D. C.*

MY DEAR SENATOR: In your letter written some weeks ago, you sent me a copy of S. 408, which revises certain sections of the Federal Reserve Act and gives each Federal Reserve bank authority to assist in financing loans having a maturity of 10 years or less with the limitation that a member bank must take at least 10 percent of the loan.

Since receiving your letter I have heard this bill discussed on various occasions and I now believe that the proposed bill is a good one. I think that banks would resort to the Federal Reserve bank for this type of loan only occasionally and that when such cases arise they would prefer to deal with a Federal Reserve bank rather than with any Government agency. Of course, it not infrequently happens now that such loans are shared among a group of banks or shared between a country bank and its city correspondent; and it seems to me that it would be well to have the Federal Reserve bank authorized also to take a part of such loans whenever for any reason it seems desirable.

Cases may arise, however, where an enterprise, particularly a new business, needs more capital and where if a loan is made to them it can only be repaid out of earnings and probably over a considerable length of time. If the local bank is willing to take a share in such a loan, I can think of no better place than the Federal Reserve bank to have the balance of it carried. I should hope that the guaranty might be in the form of a take-out agreement as this would make the proceeds of the loan more immediately available to the local banks, in case of need.

The proposed law will allow such loans to have a 10-year maturity. Personally, I feel that this is perhaps too long. A new concern or one lacking capital is apt to encounter so many changes of fortune over a 10-year period that I doubt if a commercial bank is justified in taking the risks involved, except in rare cases. I should prefer to see a 5-year maturity limit until we have more experience with this sort of loan and can determine what the results will be over the next few years.

I trust that these brief comments may be sufficient for your purposes and with my kind regards, I am

Sincerely yours,

H. E. STRAW, *President.*

EVANSVILLE CLEARING HOUSE ASSOCIATION,  
*Evansville, Ind., April 23, 1947.*

HON. CHARLES W. TOBEY,  
*Chairman, Senate Banking and Currency Committee,  
 Senate Building, Washington, D. C.*

DEAR SENATOR TOBEY: The Evansville Clearing House Association, at a meeting held this date and at which meeting all members were represented, unanimously passed a resolution in favor of Senate bill S. 408, otherwise known as the Tobey bill.

The association has directed me to notify you of this action and to respectfully request your favorable consideration of this legislation whenever you have opportunity to do so.

Cordially yours,

R. D. MATHIAS, *President.*

SMALLER BUSINESS ASSOCIATION OF NEW ENGLAND, INC.  
*Boston 16, Mass., February 20, 1947.*

HON. CHARLES W. TOBEY,  
*Chairman, Senate Committee on Banking and Currency,  
 Senate Office Building, Washington, D. C.*

DEAR SENATOR TOBEY: At their meeting on February 18, 1947, the directors of our association discussed S. 408 which is before your Committee on Banking and Currency.

We believe that this bill would benefit many small businesses and enable them to obtain needed loans. By permitting the Federal Reserve bank to give a 90 percent guaranty to local banks and other financial institutions on loans up to 10 years, made to business, the act should provide a real opportunity for small business concerns to obtain increased financial help in their own communities.

Our directors were favorably impressed by S.408 because it would make possible the release of private funds. We believe that as far as possible, the financial needs of business should be served by private enterprise and not by Government lending agencies.

The directors of our association, which has a membership of 1,100 in New England, voted unanimously on February 18 in favor of S. 408. We would appreciate having you record this vote with your committee.

Sincerely yours,

RICHARD C. COOKE,  
*General Manager.*

NASSAU COUNTY TRUST COMPANY,  
*Mineola, Long Island, N. Y., April 11, 1947.*

HON. CHARLES W. TOBEY,  
*Chairman, Senate Banking and Currency Committee,  
 Senate Chambers, Washington, D. C.*

DEAR SENATOR TOBEY: I understand there is before the Senate Banking and Currency Committee Senate bill S. 408 which would repeal the present section 13b of the Federal Reserve Act and amend section 13 of the act so as to extend, in liberalized form, certain of the powers now contained in section 13b. As a country banker I have had an opportunity to become familiar with the problems confronting small businessmen and I believe Senate bill S. 408 would provide for reasonable financial assistance for small business. I do not believe the pending bill should cause concern to chartered banking as the cases which would be considered under the proposed law would be of a kind commercial banks do not customarily consider. I believe it is important that during the postwar period which carries with it problems of reconversion adequate facilities be continued for rendering liberal credit consideration to the smaller industries of the Nation.

Respectfully,

WILLIAM F. PLOCH, *President.*

THE SECOND NATIONAL BANK OF ROBINSON,  
Robinson, Ill., April 10, 1947.

Re Senate bill 408 introduced by Hon. Charles W. Tobey, chairman, Senate Banking and Currency Committee.

HON. CHARLES W. TOBEY,  
Chairman, Senate Banking and Currency Committee,  
Senate Office Building, Washington, D. C.

DEAR SENATOR: Having familiarized myself with the various provisions of Senate bill 408, I am unable to detect any objectionable features in the bill.

It occurs to me the passage of the bill in its present form would in no way place the Federal Reserve banks in competition with the private banking system, since guaranteed loans would originate with the local banks dealing with their local people, and no loan could be guaranteed without the request of the local bank.

The operation and type of financing seems equitable and fair, and I favor the passage of the bill.

Should I be in error in my judgment in this matter and not properly informed upon the bill, and my views should differ from yours, I would appreciate very much hearing from you.

Thanking you, I remain  
Very truly yours,

THE SECOND NATIONAL BANK OF ROBINSON,  
A. H. LODGE, Cashier.

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THE FIRST NATIONAL BANK & TRUST CO.,  
Oklahoma City, Okla., April 4, 1947.

Senator CHARLES W. TOBEY,  
Senate Office Building, Washington, D. C.

DEAR SENATOR: We have just read with a great deal of interest a copy of Senate bill 408 introduced by you and which was referred to the Committee on Banking and Currency. This bill, as you will recall, repeals section 13b of the Federal Reserve Act and carries an amendment to section 13 of said act, and for other purposes.

We think that this is a decided improvement in the services the Federal Reserve banks can render member banks as the present law authorizing them to make direct loans, thus short circuiting the member banks, is practically ineffectual. This proposed bill affords a cooperative enterprise between the Federal Reserve banks and other lending institutions and provides as a lending fund private moneys accumulated by private institutions having a membership in the Federal Reserve System, rather than making loans direct from the United States Treasurer as some institutions are now privileged to make.

We feel that this is a move in the right direction, is sound and constructive, and such loans will have the benefit of the maximum amount of expert or experienced and seasoned lending authorities and will afford smaller businesses an opportunity for the best service and counsel available; wherefore it is believed that your bill has enough merit to warrant the interest and action needed in passing it at an early date.

Very respectfully yours,

HUGH L. HARRELL, Vice President.

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THE FIRST NATIONAL BANK IN BLYTHEVILLE,  
Blytheville, Ark., April 10, 1947.

HON. CHARLES W. TOBEY,  
Chairman, Senate Banking and Currency Committee,  
United States Senate, Washington, D. C.

DEAR MR. TOBEY: Our attention has been called to your recently introduced bill bearing "Senate bill 408," which provides two outstanding features, the first of which proposes to repeal the present authority of the Federal Reserve bank to make industrial loans contained in section 13-B, and providing for the return of the funds received from the Treasury, under this section.

The second section provides for the amendment of section 13, so as to confer upon the Reserve banks a more effective authority to make guaranty of loans to business enterprises.

We have studied this bill very carefully and are of the opinion that the bill should be passed, embodying both of the above-mentioned provisions.

We are of the opinion, that there is some conflict between the making of such loans on the part of the Federal Reserve banks with the RFC, through which a guaranty of 75 percent is provided for small business loans up to \$350,000. It is our opinion that the Federal Reserve banks are more adequately prepared, through their close relationship with member banks, to extend credit of a nature which will be helpful to industry and at the same time will not be detrimental to the interests of country banks.

We hope that you will give your full support to the enactment of this legislation.

Very truly yours,

SAM H. WILLIAMS, *President.*

MEXICO SAVINGS BANK,  
*Mexico, Mo., April 10, 1947.*

HON. CHARLES W. TOBEY,  
*Chairman of the Senate Banking and Currency Committee,*  
*Washington, D. C.*

DEAR MR. TOBEY: As a country banker whose institution is not always qualified, because of statutory limitations, to make loans in substantial amounts to its customers, I would appreciate the passage of the proposed Senate bill 408, provided its provisions are restricted to chartered banking institutions rather than any and all financing institutions.

If this bill is passed, it will enable the smaller institutions to advance large lines of credit to local businesses which would otherwise be compelled to go to city banks for accommodation. At the same time, the concentration of credit in any one line would not be excessive because of the Federal Reserve participation.

Any efforts you may exert to obtain passage of this bill will be greatly appreciated.

Yours very truly,

W. R. COURTNEY, *President.*

THE AMERICAN BANKERS ASSOCIATION,  
*New York 16, N. Y., April 25, 1947.*

HON. CHARLES W. TOBEY,  
*United States Senate, Washington, D. C.*

DEAR SENATOR TOBEY: On behalf of Mr. Robert M. Hanes, chairman of the small business credit commission of the American Bankers Association, I hereby file this statement of comments on S. 408. This represents the point of view of the American Bankers Association.

Respectfully,

HAROLD STONIER, *Executive Manager,*

#### COMMENTS OF THE AMERICAN BANKERS ASSOCIATION ON S. 408

The association has no objection to section 1 of S. 408 which has to do with the repeal of section 13b of the Federal Reserve Act. However, the association is opposed to that section of the bill having to do with the guaranty of commercial loans on the grounds that it is not only unwise but that there has been no demonstrated need for such legislation.

#### SMALL BUSINESS CREDIT AND THE BANKS

Before the end of the war the ABA knew that there would be a tremendous demand for credit on the part of small businessmen and returning GI's who would wish to undertake some type of business enterprise. In 1944 we organized the small business credit commission of the ABA and undertook an educational campaign across the country with our member banks to advise them of ways and means by which they could be of service to small business in the postwar period. We urged larger banks to set up small business credit departments to counsel with small businessmen. This has been done. We demonstrated how small and large banks could work together in extending loans to large and small borrowers. A number of surveys made within the past year indicate that thousands of such loans are

being made and that this practice is normal banking procedure. In addition we set up credit groups in 51 areas in the Nation to take care of loans which could not otherwise be handled. These credit groups were not designed to initiate loans themselves but were to extend additional credits wherever needed. These credit groups were banking's new postwar credit vehicle, and in some areas considerable use has been made of this vehicle. The aggregate amount of credit made available by these 51 credit groups is well over \$750,000,000.

#### AMERICAN BANKERS ASSOCIATION AND LOAN GUARANTIES

In 1943 the convention of the American Bankers Association went on record against the guaranty of loans in peacetime in the commercial and industrial fields by governmental agencies. This statement was reiterated in 1945 and again in 1947 (less than 10 days ago). It was the feeling of the association then as it is now that Government funds should not be used to underwrite the commercial and industrial risks which banks must take in the business field. The association believes that the Government's obligations are now so great that it should not undertake, especially in a period of prosperity, obligations which should be assumed by individuals and private institutions.

#### COMMERCIAL BANK LOANS AND SMALL BUSINESS DEVELOPMENT

Commercial bank loans in the small business field have expanded greatly. More new businesses were financed in 1946 than at any similar time in our history. We therefore feel that there is no need for this type of legislation at the present time. The banks are in good condition. They are anxious to make loans at reasonable rates and on fair terms to competent people to help them start new business enterprises or to develop older ones. Some people say that there is a gap in our credit structure at the point of small business. That has not been demonstrated. Small business has ample sources of credit. On the other hand, its needs are goods to sell, competent management, and tax laws which will give the little fellow or the partnership an opportunity to retain a fair share of earnings in building up capital funds for future growth.

#### SURPLUS FUNDS OF THE FEDERAL RESERVE BANKS

The ABA believes that the Federal Reserve banks' surplus accounts should be kept unimpaired and without contingent liabilities in order to enable them to underwrite any losses which such banks might experience in the normal operation of their affairs. We have now a Federal agency willing to underwrite or participate in the credit risks of the commercial banks. We contend that it would be unwise for the Government at this time to designate another quasi-governmental agency to offer to guarantee 90 percent of the loans of the banks, using funds that belong to the Government of the United States.

#### COMMERCIAL BANKS AND PRIVATE CREDIT NEEDS

The most important segment of the private credit system we have in the country are the 14,000 commercial banks. Of this number 12,000 are classified as small banks with loaning limits to one borrower of less than \$40,000. Based on a survey made by the Federal Reserve System of all loans outstanding as of November 20, 1946, of Federal Reserve member banks, the ABA projected this study to all of the banks of the country. This projection indicated that on that day there were some \$53,000 commercial loans in the portfolios of banks. Over 90 percent of these loans were for \$25,000 or less. Fewer than 10 percent were over \$25,000, indicating that the great majority of credit applications from business are in a bracket which every commercial bank is prepared to meet. The primary source of income of the smaller banks through the years has been loans to small business and to individuals.

We feel that the banks should be encouraged to carry on their risk taking without a crutch from any governmental or quasi-governmental agency and not be placed in the position of receiving preferential treatment as against any other private enterprise.

For these reasons we respectfully file these objections to the guaranty section of S. 408.

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GUARANTIES OF BUSINESS LOANS THROUGH THE  
FEDERAL RESERVE SYSTEM

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APRIL 28 (legislative day, APRIL 21), 1947.—Ordered to be printed

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Mr. TOBEY, from the Committee on Banking and Currency,  
submitted the following

R E P O R T

[To accompany S. 408]

The Committee on Banking and Currency, to whom was referred the bill (S. 408) to repeal section 13b of the Federal Reserve Act, to amend section 13 of the said act, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that, as amended, the bill do pass.

STATEMENT

The bill has two principal purposes. In order to carry out a recommendation of the President in his budget message for 1948 the bill 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, about \$27,500,000, and would eliminate any further claim upon the Treasury for any part of the \$112,000,000 which was appropriated by Congress and is now set aside on the books of the Treasury for this purpose. The committee is in agreement with the President that it is desirable that these funds, totaling about \$139,000,000, be now released to the Treasury for other uses.

The other principal purpose of the bill is to provide assistance in the furnishing of necessary financing to business enterprises in times of need through partial guaranties of loans made by banks. It is the view of the committee that authority for such guaranties should be provided in the law, and also that it should properly be vested in the Federal Reserve System. The Reserve banks are permanent institutions with offices throughout the country and they have had a considerable experience in the field of financing business through partial guaranties both under section 13b of the Federal Reserve Act and, during the war, in the financing of war production under the V-loan program.

The bill would repeal the present restrictive industrial loan authority of the Federal Reserve banks, contained in section 13b of the

Federal Reserve Act, and would substitute therefor a more effective authority to guarantee loans made by chartered banking institutions to business enterprises. This authority would be contained in a new paragraph to be added to section 13 of the Federal Reserve Act. No loan guaranteed could have a maturity of more than 10 years. The percentage of the loan guaranteed in any case could not exceed 90 percent; in other words, the banking institution would be required to assume 10 percent or more of the risk in any loan. The aggregate amount of all guaranties could not exceed the combined surplus of the Federal Reserve banks; and, in order to insure the availability of guaranties for loans to smaller businesses, the aggregate amount of all guaranties which are individually in excess of \$100,000 could not exceed 50 percent of the combined surplus of the Reserve banks. All operations of the Reserve banks would be subject to the regulatory supervision of the Board of Governors of the Federal Reserve System.

In this connection, the committee have adopted two amendments originally suggested by the Federal Advisory Council and recommended by the Board of Governors of the Federal Reserve System. By the first of these amendments, the words "chartered banking institutions" have been substituted for "financing institution," so that in effect loans may be guaranteed under the bill only if made by incorporated banks.

The second amendment would authorize a Federal Reserve bank to guarantee a loan only when it appears to the satisfaction of the Reserve bank that the business enterprise is unable to obtain requisite financial assistance on a reasonable basis from the usual sources. The committee believe that guaranties should not ordinarily be made available to banks in cases in which the amount of the loan is beyond their legal limit, if the loan is of such quality that it may be made without the guaranty by giving participations to other banks to which it would be natural for the smaller banks to turn for assistance in such cases.

It is also the view of the committee that the authority provided by the bill should be limited initially to a period of 5 years and, accordingly, it has approved an amendment terminating the authority on June 30, 1952. At that time, of course, Congress may deem it desirable to extend the authority or place it on a permanent basis.

No Government appropriations or drain on the Federal Budget would be involved in operations under the bill. The Reserve banks would use their own surplus funds in carrying out their authority to make guaranties; and any losses sustained would first come out of the fund created from the receipt of fees charged for guaranties. If that fund should not be adequate, losses would be met out of the net earnings or surplus funds of the Reserve banks.

This bill would not place the Federal Reserve banks in competition with the private banking system. They would not have authority, as under present law, to make direct loans to business enterprises. Credit judgment and responsibility would remain primarily with the lending bank. Loans guaranteed would originate with local banks dealing with local concerns with which they would be familiar. A Federal Reserve bank could not guarantee any loan unless requested to do so by the local bank; but when approved by the Reserve bank, the guaranty would be made promptly available without referring the matter to any agency in Washington.