

DEPARTMENT OF COMMERCE  
OFFICE OF THE SECRETARY  
WASHINGTON 25

March 25, 1947

Honorable 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 indorse 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 guarantees 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 anti-monopoly 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 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 guarantee 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 guarantee provided by this legislation is virtually tantamount, as a practical matter, to a guarantee 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 four percent rate mentioned in that bill.

In addition, although we feel strongly that legislation of this character should provide credit assistance by extending guarantees, 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 guarantees or of the funds available for commitments. 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 per centum 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 exploration.

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,  
(Signed) William C. Foster

Acting Secretary of Commerce.