

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

March 31, 1947.

Mr. Harold Stonier, Executive Manager,  
American Bankers Association,  
12 East 36th Street,  
New York 16, New York.

Dear Hal:

Attached is a copy of a letter which I felt obliged to send to the editor of the American Banker in order to correct the extremely unfair and untrue picture painted in a recent speech by Walter B. French in connection with the bill proposing to repeal section 13b of the Federal Reserve Act and to substitute a provision for guaranteeing in part loans by private banks. This measure has the united support of the entire Federal Reserve System; that is, the Board and the presidents of the twelve Banks, as well as the Federal Advisory Council who are representatives of the private banks in all of the Federal Reserve districts.

Mr. French appears to be speaking for the American Bankers Association in his capacity as Deputy Manager, and it would seem that he was endeavoring to drive a wedge between the Federal Reserve System and the ABA. Apart from the gross unfairness of his attacks, I find it difficult to understand how the Association can appear to be sponsoring an opposition which is not an accurate reflection of the views of informed leading bankers throughout the country.

Sincerely yours,

(Signed) M. S. Eccles

Attachment

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

March 31, 1947.

Mr. C. B. Axford, Editor,  
American Banker,  
32 Stone Street,  
New York City.

Dear Sir:

In a recent issue the American Banker printed excerpts from a speech by Walter B. French, Deputy Manager of the American Bankers Association, attacking the bill introduced by Senator Tobey which would enable Federal Reserve Banks to continue and improve their service, particularly to small business, through guarantee in part of loans by private banks. Mr. French's statements were so unfair and such a gross misrepresentation of the facts that I felt compelled to send you this statement to correct the false impressions that his speech created.

His most flagrant statement was to the effect that the proposed bill constituted a threat to the existence of the dual banking system. Nothing could be further from the truth. Congress gave the Reserve System authority in 1934 to make industrial loans directly or to participate in them with private banks. Under this authority some 3500 applications for commitments and advances, aggregating 566 million dollars, were approved by the Federal Reserve Banks and their branches. That did not threaten the dual banking system. During the war the Reserve Banks and branches, under the V-loan program, made 8771 guarantees of war production loans, aggregating nearly 10.5 billion dollars. That did not threaten the dual banking system. The idea that it did or could does not seem to have occurred to anybody but Mr. French.

Mr. French predicted that "this proposal would encourage loose lending and further inflate the economy." He charged, in effect, that the Reserve Banks, under pressure from the Reserve Board, would approve unsound loans. Such assertions impugn the judgment and good faith not only of the Reserve Board but of the officers and staffs of the Reserve Banks and branches who have had responsibility for the 11 billions of similar credit operations in the past and who would have the responsibility for them in the future. The interest and fees collected in connection with the 566 million dollars of operations under 13b exceeded all expenses and losses entailed. Likewise, interest and fees collected in connection with nearly 10.5 billion dollars of credit operations under the V-loan program were sufficient to cover all expenses and losses and to result in a substantial profit. This is hardly a record of "loose lending."

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His prophecy as to inflation is equally unfounded. It certainly would not make for inflation if small business is helped in producing goods. This measure would be of particular benefit to the smaller banks in enabling them to extend term credits especially to small business that cannot afford to go to the capital market. There are instances in which term loans for a period up to as long as ten years should and can be made on a sound credit basis, but probably could not and would not be made by banks if they felt they had to assume the entire responsibility.

Mr. French stated that credit judgment and responsibility belong with the lending bank. That is exactly where it would be under the guarantee program. The bill does not place the Reserve Banks in competition with the private banking system. 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 would not guarantee any loan unless requested by the local bank; but if such a guarantee is desired it would be promptly available, when approved by the Reserve Bank, without referring the matter to any agency in Washington. The twelve Federal Reserve Banks and their twenty-four branches provide a regional organization through which local financing institutions in all areas of the country would have convenient access to a guaranteeing agency.

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 per cent and it is contemplated that the initial maximum rate under the new legislation would be the same. Within this limit, which may be subject to change with changing conditions, interest rates would be determined by the borrower and the bank. Guarantee fees charged would be specified percentages of the interest rate, graduated according to the percentage of the loan guaranteed. The method would be similar to that used in the V-loan program, when guarantee fees ranged from 10 to 30 per cent of the interest rate, according to the percentage of the guarantee. This has been and would be the operating procedure.

A basic need of small, independently owned business enterprises is long-term funds. Some businesses need funds for modernization of equipment and some need special labor-saving facilities in addition to other requirements. The need also arises from the great increase in prices and greatly expanded volume of business which have come about in recent years and which have resulted 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 financing on a longer-term basis.

Mr. C. B. Axford - (3)

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Owners of small enterprises characteristically prefer to obtain their funds on a loan rather than an equity basis, because they do not wish to permit a dilution of their own interests or to run the risk of losing control of their businesses. For this purpose term loans, amortized out of profits, are essential and desirable. This type of financing is particularly suitable for small businesses, which need a substantial period of time to retire loans by gradual repayment from earnings.

Although large corporations secure a substantial amount of funds through term loans, the greater part of their need for long-term funds is met through security issues, a source not available to small concerns. The amount of long-term funds that the individual enterprise needs is relatively small. Many of these loan demands do not exceed \$10,000 and relatively few exceed \$100,000.

It should be borne in mind that if the proposed legislation is enacted, the Federal Reserve Banks will be drawing on their reserve funds and not on Government appropriations in the guarantee operations. No drain on the Federal budget is involved, and the very fact that the Reserve Banks would use their surplus funds and not appropriated money, as was the case under 13b and also under the V-loans, is hardly likely to lead to the "loose lending" that Mr. French professes to fear.

Business and credit conditions at present and at other times may not be such as to require extensive use of the guarantee authority which this bill provides. However, the Reserve Banks should have a stand-by authority of this kind in order that partial guarantees may be promptly available whenever 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 business relationships with banking institutions. Moreover its responsibilities for maintaining sound credit conditions make it the appropriate agency for this purpose.

In the light of the facts and of the record, Mr. French's attacks are wholly unjustified and unfair. This proposal should be considered on its merits.

Very truly yours,

(Signed) M. S. Eccles

M. S. Eccles,  
Chairman.

*frs*

THE AMERICAN BANKERS ASSOCIATION

TWELVE EAST THIRTY-SIXTH STREET  
NEW YORK 16, N.Y.

HAROLD STONIER  
EXECUTIVE MANAGER

April 3, 1947

Honorable Marriner S. Eccles, Chairman  
Board of Governors  
Federal Reserve System  
Washington, D. C.

Dear Marriner:

Thanks for your note of the other day enclosing copy of the letter you sent to the American Banker. As usual, you have set forth your case very clearly.

For several years we have had a commission in the Association called the Small Business Credit Commission. It has been the objective of this commission to urge banks to take risks from competent people on loans for constructive purposes without recourse to insurance or guaranty set up by any governmental agency. Mr. French's speech was based upon that resolution of our convention in 1943.

*workshop*  
As you indicate, a number of our leading bankers are in favor of the Tobey Bill and a number of others feel that the Tobey Bill should be opposed on the grounds that it is contrary to our convention resolution of 1943. As is the case in all questions of this character, we find that bankers are of different opinions. Somebody has said that that is what makes a horse race.

Hope to see you soon.

Sincerely yours

*Hal*  
Executive Manager

April 4, 1947.

Dear Mr. Axford:

This is just a word to thank you for the admirable way in which you handled and presented my letter to you with reference to the bill to authorize the Reserve Banks to guarantee loans.

I think this will be helpful, and I have sent copies of the letter to all of the Federal Reserve Bank presidents for their information.

Again thanking you, I am

Sincerely yours,

Mr. C. B. Axford, Editor,  
American Banker,  
32 Stone Street,  
New York City.

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