BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date December 12, 1947

To Chairman Eccles

From Ralph A. Young

MESSAGE:

Attached are copies:

(a) The Senate Banking and Currency Committee's Report to the Senate on S. 408.

(b) The Board's original statement accompanying the recommendation for the repeal of 13b and amendment of 13.

Special note: Remind the Subcommittee that the Senate Banking and Currency Committee has already reported out S. 408 favorably.

Statement 12/12/47

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Message delivered by _____

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80TH CONGRESS, 1st Session | SENATE | REPORT No. 145

GUARANTIES OF BUSINESS LOANS THROUGH THE FEDERAL RESERVE SYSTEM

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

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

REPORT

[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.

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

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

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

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

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

Provisions of the Bill

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

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

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

Revision of Existing Authority of Reserve Banks

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

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

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

Direct Lending Eliminated

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

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