

December 21, 1950.

R.F.C. File

Governor Eccles:

I attach a summary of the proposed bill to amend the law with respect to the Reconstruction Finance Corporation, together with a memorandum of comments on some aspects of the measure. These documents were prepared by Mr. Walter Young, an attorney who joined our staff several weeks ago after spending a number of years as a member of the staff of the RFC.

If you would like the memorandum revised or changed in any way, please let me know.

GBV

Attachments

December 21, 1950.

Dear Senator:

I am enclosing herewith a summary of the proposed Reconstruction Finance Corporation Act, together with comments on the proposed Act. These documents were prepared by Mr. Walter Young under the direction of Mr. Vest, the Board's General Counsel. Mr. Young is one of our lawyers and was a member of the staff of the RFC for a number of years.

I strongly believe that the legislative proposal to substitute an administrator for a Board of Directors is a very desirable and practical change under existing circumstances. After I return to Washington in January I will be very glad to discuss with you, at your convenience and in case you desire to do so, the reasons which seem to favor the kind of organization you propose.

Sincerely yours,

M. S. Eccles.

Hon. Wm. J. Fulbright,
United States Senate,
Washington, D. C.

COMMENTS ON PROPOSED RFC ACT

The proposed RFC Act represents, in general, a substantial improvement over the present Act and, if enacted into law, should place the operations of the Corporation on a sound basis, improve administration, more clearly delineate its field of operation, and provide more adequate accounting controls.

The substitution of a single administrator (governor) for a board of directors represents a fundamental change in the organizational structure of the Corporation. Certainly the fact that the Congress would be in better position to fix responsibility (which is frequently difficult in the case of a board of directors) recommends such a change. On the other hand, a board might more effectively withstand inevitable pressures, which undoubtedly are sometimes severe, than could a single individual. However, in the final analysis this would depend entirely upon the caliber of the man who might be selected for governor.

Any Government agency which is authorized to engage in direct lending of public funds should be required to operate on a self-sustaining basis not only as to the total lending program, but also to the extent possible as to each major category of loans. This cannot be accomplished unless all costs of operation, both direct and indirect, are taken into account, and unless an interest rate is fixed for loans sufficient to provide for these costs, as well as losses sustained on

loans. The proposed bill recognizes that it would be neither feasible nor desirable to fix by statute a rigid interest rate. However, the provision requiring the Corporation to establish interest rates to cover all expenses is most desirable.

Obviously, the Government should not lend money in those areas where, or during such times as, adequate credit is available from private sources, nor should the Government provide credit at interest rates lower than prevailing rates. Section 4(a), which authorizes loans only after a determination that "financial assistance is not otherwise available at prevailing rates", should be adequate to provide reasonable assurance that lending by the Corporation will be confined to a sphere outside that in which private institutions operate.

In this connection, however, consideration might be given to the addition of some clarifying language. Does the phrase "prevailing rates" mean the average rate in the geographical area or the rate for the type of loan requested? In other words, just how is the prevailing rate to be determined? The additional requirement in section 4(a) that when credit is extended a finding be made to the effect that a "substantial public interest would be served", gives desirable emphasis to the importance of coordinating the Corporation's lending with the activities of those agencies of the Government which have important fiscal responsibilities.

The language in the proposed Act relating to security is identical with that contained in the present law. The requirement is

that all securities and obligations and all loans except catastrophe loans "shall be of such sound value or so secured as reasonably to assure retirement or repayment". The RFC for a number of years has construed this provision rather liberally. The Board has considered that if there are reasonable grounds to believe that the loan will be retired (1) from earnings, (2) by "balloon" payment, (3) by a refinancing arrangement, (4) by liquidation of collateral, or (5) any combination of the foregoing, then the statutory requirement has been met. The proposed Act, while retaining the old security provision, also requires that there must be reasonable cause to believe that business loans will be retired from earnings within ten years. This has the desirable effect of tightening up the present security requirements as interpreted over a period of years.

It is noted that the bill provides an appropriation as the source of funds which the Corporation is to employ in its operations, rather than, as at present, borrowing on its own notes from the Treasury of the United States. The appropriation is to be used as a revolving fund. There would be no objection to this providing the Corporation, as a result, would not be subject to the Budget and Accounting Act. It is questionable whether a business operation can function efficiently if it is subject to the same pre-audit as the usual governmental operation. It seems clear, however, that such a pre-audit is not required since section 3, which authorizes the governor to determine the necessity for and the character and amount of the Corporation's

obligations and expenditures and the manner in which they shall be incurred, allowed, paid and accounted for, makes such determination final upon all officers of the Government.

As a preliminary to actual operations under the new Act, it is proposed that the present capital stock of the Corporation held by the Treasury be retired and that the funds which the Corporation is now using interest free, representing accumulated profits, shall be paid into miscellaneous receipts of the Treasury. Presumably the purpose of these two steps is to make it possible properly to evaluate results in terms of profit or loss to the Government as a whole. Certainly there is no necessity for a wholly owned Government corporation to have capital stock outstanding, and the accumulated profits which the Corporation now uses interest free are in fact funds belonging to the Government of the United States. Once these preliminary steps are taken the Corporation could draw on its appropriation, paying for the use thereof an amount to be calculated on the basis of current average rate paid by the Treasury on its marketable obligations. These provisions establish a basis by which results may be accurately assessed.

The accounting controls under which the Corporation would operate pursuant to the proposed Act appear to be adequate. Under section 1(b) it would be required to maintain its financial records in accordance with generally accepted accounting principles applicable to commercial corporate transactions which would include the maintenance of adequate cost accounting records. These would form the basis of

the annual reports required to be made to the Congress. The Corporation would also be subject to the Government Corporation Control Act. These controls, together with the reorganization of the financial structure referred to above, should be sufficient.

It is noted that two loans presently outstanding by the Corporation, namely, the loan to the Steep Rock Iron Mines, Ltd., and the loan to the United Kingdom of Great Britain and Northern Ireland, as well as the mortgages which originated under the authority of The RFC Mortgage Company are proposed to be transferred to the Export-Import Bank in Washington, to the Secretary of the Treasury and to the Housing and Home Finance Administration, respectively, and the Corporation is to be reimbursed for all unpaid balances of the loans plus accrued interest. These loans were made and the mortgages were purchased under authority which the RFC does not now have and would not have under the proposed Act. Their administration is not, therefore, in the same category as what might be termed the normal operations of the RFC. Substantial amounts of money are involved and the annual interest payments are favorably reflected on the annual financial statement of the Corporation. The profit derived therefrom undoubtedly enables the Corporation to carry other programs which, if considered separately, perhaps would show substantial losses. The only question involved in a transfer of these three items to other agencies would seem to be whether they could be better administered elsewhere. If it is so

determined then they should be transferred, otherwise they should remain with the RFC. In case of the latter, separate accounts could be maintained for these three items so that, for accounting purposes, the normal operations of the Corporation would not be affected thereby.

A completely new provision is included in the proposed Act which would require the Corporation to maintain docket for public inspection of each application and of each loan made. The docket would contain all pertinent information including the names of persons who (1) have represented the applicant, (2) have interceded for him, or (3) have attempted to influence the Corporation for or against him. This provision, of course, represents a departure from the policies followed normally by private financial institutions. It is clearly apparent that the purpose of the provision is to surround the lending of public funds with every possible safeguard against improper influence. While normally the relation between the lender and the borrower is confidential, nevertheless when public funds are involved it seems justifiable that a full disclosure be made of all facts surrounding the making or the declining of a loan application. While it may work a hardship in certain isolated cases the over-all net benefit and protection which the public receives far outweighs this consideration. In addition, there is more likelihood that the highest public confidence in the operations of the Corporation can be maintained by such a requirement.

Also of importance in so far as maintaining public confidence is concerned is section 4(b)7 which prohibits borrowers, for two years

after a borrowing from the Corporation, from employing officers or other persons in the employ of the Corporation who have exercised discretion in the granting of loans. While perhaps this may have occurred only infrequently in recent years the practice is certainly one to be discouraged. There have been instances only recently where the publicity attendant on such employment by RFC borrowers has raised serious doubts in the public mind as to the propriety of the action. Section 4(b)7 is a reasonable provision and should have a salutary effect on public confidence in the Corporation. Further, and of at least equal importance, the provision will reduce the danger of public officials actually using their positions for selfish or personal advantage.

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SUMMARY OF THE PROPOSED RECONSTRUCTION
FINANCE CORPORATION ACT

Administration.

The Board of Directors is abolished and there is substituted a governor who is authorized to appoint two deputy governors. Applications for loans of \$100,000 or more may be approved only by the governor and if such action is taken against the recommendation of the Corporation's highest reviewing authority, reasons for the governor's action must be made a matter of record. (new provision)

Lending Powers.

The Corporation is authorized to make loans directly or in participation with banks in four broad categories:

1. Business enterprises.
2. Financial institutions and in the case of insurance companies to subscribe for or make loans upon non-assessable preferred stock.
3. Public agencies.
4. Catastrophe loans.

No express limitation is fixed for the amount outstanding at any one time in the case of business loans. However, in the case of catastrophe loans a limitation of \$40 million is fixed, for public agencies \$200 million, and insurance companies \$15 million.

In all but catastrophe loans there is a requirement that credit must not be otherwise available at "prevailing rates" (existing law uses the phrase "on reasonable terms") and all securities and obligations purchased and loans made must be of such sound value or so secured as

reasonably to assure retirement or repayment. In the case of business loans there must be reasonable cause to believe that they may be retired from earnings within ten years. (new provision)

Except in certain limited areas, maturities on business loans shall be no more than 10 years. In the case of public loans, the maximum maturity is fixed at 40 years.

In the case of deferred participations, the Corporation is limited to 70 per cent of the loan where the entire amount is \$100,000 or less, and 60 per cent where over \$100,000.

No specific interest rate is fixed on loans made by the Corporation. It is provided, however, that the general policy of the Corporation shall be to establish interest rates that will cover all expenses of the Corporation as well as providing for losses on loans. (new provision)

Source of Funds.

The present authority of the Corporation to borrow on its own notes from the Treasury is terminated. Funds are to be supplied through an appropriation (the amount not yet determined) which is to be used as a revolving fund. Out of this appropriation also the Corporation is required to pay all existing indebtedness to the Treasury and retire the capital stock presently held by the Treasury and the funds which the Corporation is now using interest free, representing accumulated profits, are to be paid into miscellaneous receipts of the Treasury. Annual payments by the Corporation are required to cover costs incurred by the Government in supplying funds. The amount is to be calculated on the basis of the current average rate paid by the Treasury on its marketable

obligations.

Reports to Congress.

The Corporation is required to make an annual report to the Congress which is to include a statement of income and expense for major classes of loans and an analysis of accumulated net income. In order that necessary data may be available for such reports, the Corporation is required to maintain adequate cost accounting records.

Public Inspection of Dockets.

The Corporation is required to maintain for public inspection a docket of each application and of each loan made and the docket is to contain all pertinent information including the names of persons who (1) have represented the applicant; (2) have interceded for him; or (3) have attempted to influence the Corporation for or against him.

Transfer of Certain Presently Outstanding Loans to other Governmental Agencies.

To the Export-Import Bank of Washington the loan to the Republic of the Philippines and the loan to the Steep Rock Iron Mines, Ltd.

To the Secretary of the Treasury the loan to the United Kingdom of Great Britain and Northern Ireland.

To the Housing and Home Finance Administrator all mortgages which originated under authority of The RFC Mortgage Company.

In each of the above instances, the Corporation is to be reimbursed by the receiving agency for all unpaid balances of the loans plus accrued interest.

Functions of Federal Reserve.

The Federal Reserve Banks are directed to act as custodians and fiscal agents for the Corporation, and the Federal Reserve Board and the Federal Reserve Banks, together with other agencies of the Government, are directed, under such conditions as they may prescribe, to make available to the Corporation such information as they may have relating to applicants and borrowers.