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## INDUSTRIAL LOANS

When the Federal Reserve Banks were established they were authorized to discount for member banks only certain eligible types of paper. These represented advances of credit for short terms only on the basis of commercial and agricultural activities. The idea in limiting the discount powers of the Federal Reserve Banks to these classes of paper was to facilitate the use of bank credit for legitimate commercial and productive purposes, and to discourage its use for speculative and nonproductive purposes.

Without departing from this objective, it has been found necessary from time to time in recent years to modify the limitations in the original Act. Most of these departures were made as the result of emergency needs arising during the depression. It was for this reason that in 1932 the Federal Reserve Banks were authorized under certain conditions to make advances to member banks on the basis of any collateral satisfactory to the Reserve Banks. In the Banking Act of 1935 this provision, which had previously lapsed, was restored to the Federal Reserve Act in Section 10b and made more general in its application. The result is that at the present time, as you know, Reserve Banks may make advances to member banks on any type of collateral satisfactory to them, provided the paper has not more than four months to run. This power is no longer restricted, as it formerly was, to periods of emergency. Advances of Federal Reserve Bank credit on such bases as well as on the basis of the class of paper originally defined as eligible are now within the scope of the regular powers of the Federal Reserve Banks. At the present time, of course, when banks in general have an abundance of funds, the authorization for the Federal Reserve Banks to make such advances has little occasion to be exercised. If the banks have occasion to borrow in the future as they have in the past, however, these powers may come to be of great importance.

There is one special type of loan which the ordinary bank would probably hesitate to make if the law did not permit the loans to be discounted at the Reserve Bank on especially favorable terms. These are working capital loans with five year maturities, authorized by Section 13b of the Federal Reserve Act.

The difference between Section 10b and 13b is mainly that 10b authorizes advances on any satisfactory collateral for not more than four months; whereas 13b authorizes advances and discounts for working capital purposes for not more than five years.

The powers to discount industrial loans were given to the Federal Reserve Banks under the terms of an Act of June 19, 1934, which added Section 13b to the Federal Reserve Act. The adoption of this measure was preceded by considerable discussion as to the proper means of making credit available to business enterprises whose working capital had been depleted. One suggestion that has often been made is that there should be intermediate credit banks established for the purpose. The basis for the suggestion usually is that small business enterprise has great

difficulty in procuring capital. Whatever the merits of this question, Congress decided to use an existing agency rather than establish new ones, and to provide the facilities aimed at through extension of the powers of the Federal Reserve Banks.

The amendment which was adopted authorized the Federal Reserve Banks to discount loans made by member banks and others for working capital purposes, or in cases where credit was not procurable from the usual sources to make such loans direct. The law stipulated that the loans were to be made to established industrial or commercial enterprises; they were to be for the purpose of furnishing working capital; and they were to have maturities not exceeding five years. With respect to such loans to be discounted by the Federal Reserve Banks, the law reads as follows:

"Each Federal Reserve Bank shall also have power to discount for, or purchase from, any bank, trust company, mortgage company, credit corporation for industry, or other financing institution operating in its district, obligations having maturities not exceeding five years, entered into for the purpose of obtaining working capital for any such established industrial or commercial business; to make loans or advances direct to any such financing institution on the security of such obligations; and to make commitments with regard to such discount or purchase of obligations or with respect to such loans or advances on the security thereof, including commitments made in advance of the actual undertaking of such obligations. Each such financing institution shall obligate itself to the satisfaction of the Federal Reserve bank for at least 20 per centum of any loss which may be sustained by such bank upon any of the obligations acquired from such financing institution, the existence and amount of any such loss to be determined in accordance with regulations of the Board of Governors of the Federal Reserve System."

You will notice that the Federal Reserve Banks may make these discounts not only for member banks, but for non-member banks or any other type of financing institution.

The arrangements that may be made under this authorization are extremely favorable to the bank which desires to make the loans in cooperation with the Federal Reserve Bank; for the commitment which the Federal Reserve Bank is authorized to grant is an agreement under which a local bank may carry such a loan in its own portfolio at a good rate of interest and with the privilege of disposing of it at any time at the Federal Reserve Bank. Moreover, when it is sold or transferred to the Federal Reserve Bank, the latter will assume without recourse as much as 80 percent of any eventual loss on the loan. The commitment, therefore, gives the local bank assurance that the loan is perfectly liquid even though it may run for a period of five years, and also that its own loss on the loan may be limited to 20 percent.

The Federal Reserve Bank of San Francisco makes a charge of from 1/2 to 2 percent per annum on the commitments it grants. The exact rate depends upon various factors of credit risk, maturity, etc. It

charges a discount rate of from 3 to 4 percent on that portion of any loan for which the bank which made the loan retains obligation, and from 4 to 5 percent on that portion from which the bank which made the loan is released from obligation.

In granting a commitment, of course, the Federal Reserve Bank has to consider the credit risk exactly as if it were making the loan itself. It may be said indeed that the Federal Reserve Bank assumes somewhat more risk in granting a commitment than in making a direct loan, since a loan which it makes itself is under its own immediate care, whereas a loan held by another institution is not. Obviously the circumstances are such that the Federal Reserve Bank must be assured that the loan is a good one and that it will be properly serviced. In practice, therefore, applications for such loans are usually considered simultaneously by the Federal Reserve Bank and by the bank which contemplates making the loan.

In cases where a loan is refused by the local banker but is considered by the Federal Reserve Bank a good loan, the Reserve Bank may make it direct. Under such circumstances it cannot be said that the Reserve Bank is competing with member banks. The Reserve Banks in general prefer that local business be handled by local banking agencies. They do not desire to develop direct banking relations with the public as a matter of policy in any cases where local banking facilities are adequate.

As you know, the central banks of some other countries, for example, the Bank of England and the Bank of France, have a certain amount of private business which they conduct in competition with other banking institutions. Before their central banking functions developed, these institutions had much more of such business. The private business which they still have, however, is not essential to their functioning as central banking organizations. The same thing is true in the United States. The basic functions of the Federal Reserve Banks are central bank functions. The Reserve Banks are in the main intended to supplement regular banking facilities and to stand in reserve behind the local banks. They are not competitors of their members.

It is now nearly two years since the Federal Reserve Banks were given the authority I have been discussing. In that period they have received, as of June 3, 8,127 applications of which 2,165 have been approved. The total amount that has been applied for is \$330,026,000. The amount approved is \$132,626,000. Of this amount, \$27,144,000 has been conditionally approved, and \$105,482,000 finally approved. These final approvals include direct advances outstanding of \$30,701,000 and commitments outstanding of \$24,878,000. Repayments have amounted to \$14,988,000. Withdrawals of approved applications, etc. have amounted to \$21,676,000. Financing institutions participations with the Federal Reserve Banks have amounted to \$11,970,000, and there is in process of completion advances and commitments of about one and one-quarter million.

During the same period, that is since June, 1934, the Federal Reserve Bank of San Francisco has received 1,065 applications, of which 254 have been approved. The total amount applied for was \$31,324,000, and the amount approved was \$11,942,000. Outstanding advances now amount to \$1,668,000, and commitments outstanding amount to \$4,363,000.

Repayments have amounted to \$150,000. The Bank now has in process of completion approved advances and commitments of about \$463,000.

The statute limits the amount available for these loans and commitments to \$280,000,000 for all the Federal Reserve Banks, of which the Federal Reserve Bank of San Francisco has \$19,500,000. This constitutes a revolving fund, so that as payments are received and new loans made, the total credit that may be extended far exceeds the amount mentioned.

In order to assist the Federal Reserve Banks in dealing in a field of credit which Congress felt might be new to them, it provided that each Reserve Bank should have an Industrial Advisory Committee. The members of the Industrial Advisory Committee of the Federal Reserve Bank of San Francisco are as follows:

Stuart L. Rawlings	V.P., Calaveras Cement Co.	San Francisco, Calif.
Ralph Burnside	V.P., Eatonville Lumber Co.	Eatonville, Wash.
Shannon Crandall	Pres., Calif. Hardware Co.	Los Angeles, Calif.
Henry D. Nichols	V.P., Tubbs Cordage Co.	San Francisco, Calif.
William G. Volkmann	Sec., A. Schilling & Co.	San Francisco, Calif.

All applications received by the Reserve Bank are considered by the Industrial Advisory Committee and recommended for approval or disapproval. The Bank's action, however, is final. It is lending its own funds and it has the say as to whether or not a loan should be made. Consequently it may reject a loan recommended by the Industrial Advisory Committee or it may decide to make one even though the Industrial Advisory Committee's recommendation is adverse.

Furthermore, applications are not referred to Washington. They are considered and passed upon finally by the Reserve Bank of the district in which they originate. The Board in Washington, D. C. merely issues general regulations for the administration of Section 13b and supervises the activity for the entire system.

While you may have full knowledge of this section and while you may have already availed yourself of its provisions, it seems entirely proper that we should remind business men from time to time of the service that is being rendered by an institution that was originally intended to be only a banker's bank. It is with this purpose in mind that I speak to you on this subject today.

There has been a falling off during recent months in the number of applications submitted for industrial loans, as the following figures for all districts show.

Period since enact- ment of Section 13b June, 1934	Applications Received		Applications Approved	
	Number	Amount	Number	Amount
1st 6 months	5053	\$188,000,000	984	\$50,000,000
2nd 6 months	1565	75,000,000	662	39,000,000
3rd 6 months	997	44,000,000	347	35,000,000
4th 5 months	512	23,000,000	172	9,000,000

While the above figures show a marked falling off in the number and amount of applications received and approved, it is important to observe that the proportion of approvals has greatly increased. In the first six months, that is, from June to December 1934, only 19% of applications were approved and only 27% of the amount represented was approved. In the first five months of this year, 33% of applications were approved and 37% of the amount involved was approved. These figures indicate that the average quality of the applications is now much better than it was in 1934.

The smallest amount of any loan made to date in the 12th district is \$500, and several loans of this amount have been granted. The largest single loan approved in this district was for \$1,000,000.

Many banks have found it desirable to make these industrial loans even without Federal Reserve Bank participation. Not all such cases are reported, but the Federal Reserve Bank of San Francisco has been informed that 72 applicants, applying altogether for \$1,715,000, have received loans without participation by the Reserve Bank. Some borrowers who originally obtained credit from the Federal Reserve Bank have subsequently borrowed from local banks and paid off the obligation to the Federal Reserve Bank before maturity.

The principal lines of business which have received 13b credit in this Federal Reserve district are the following:

Kind of Business	Number of Appli- cations Approved	Amount Approved
Manufacturing	91	\$ 3,912,000
Lumber	36	3,784,000
Wholesale and Retail	90	1,954,000
Packing	21	865,000

In addition to the Federal Reserve Banks, the Reconstruction Finance Corporation has also authority to make loans of similar nature and for similar purposes.

It has been my opinion that the more often we discuss the Federal Reserve System, the more firmly will its functions become directed toward the accommodation of commerce, industry, and agriculture, as was intended in the original Act. That is why I appreciate the opportunity you have given me to say these words about this particular, new function of the Federal Reserve Banks in the field of working capital loans.