FEDERAL RESERVE BANK
OF RICHMOND

June 18, 1940

Board of Governors
of the Federal Reserve System,
Washington, D. C.

Dear Sirs:

At their regular monthly meeting held on June 13, 1940, the directors of this bank gave consideration to your letter of May 17, 1940, R-656, in which you expressed your desire to learn whether, in the light of the experience of this bank, its directors and officers would favor the Mead-Ford proposal, the Frank proposal, or some other type of legislation. In response, I am pleased to submit the following:

EXPERIENCE OF FEDERAL RESERVE BANK OF RICHMOND
WITH INDUSTRIAL LOANS

There is attached a brief memorandum which gives a summary of the experience of this bank with industrial loans from June 19, 1934, to May 22, 1940. Of 186 loans amounting to $11,097,000 actually disbursed, we assumed a total risk of $9,536,000, as compared with $1,716,000 for participating financial institutions. Actual and estimated losses at December 31, 1939 amounted to $557,346.39, which amount was $50,948.58 in excess of net earnings from the beginning of operations to the end of 1939. Only twelve applications amounting to $263,000 were received during the past year, eleven of which were approved.

IS THERE ANY NEED FOR ADDITIONAL AGENCIES TO MAKE
TERM LOANS?

Our directors and officers believe

(1) That banks are now extremely reluctant to refuse applications for credit and that they are disposed to examine each unacceptable application

with care with the hope that it can be put in bankable form.

(2) That banks are so desirous of finding suitable ways to put their funds to work that they actively engage in soliciting loans.

(3) That more emphasis is now being placed on ultimate goodness and less on liquidity in passing upon applications for credit, and as a consequence many loans are now being made when it is known at the time that the proceeds will be used for fixed rather than working capital purposes.

(4) That applications for long-term loans declined by commercial banks and the Federal Reserve Bank or the Reconstruction Finance Corporation should not be approved by any lender, for they certainly lack the minimum elements of soundness.

(5) Finally, that there is no need whatever to establish any additional agency for the purpose of making term loans.

IS THE MEAD-FORD PROPOSAL DESIRABLE?

While it is not believed that this bank would have had an opportunity to make a very large number of sound industrial loans during the past year, if the Mead-Ford proposal had been in effect, it probably would have made many more than it did.

If Federal Reserve banks are to continue to make industrial loans, it would seem advisable to eliminate unnecessary restrictions. Of the three provisions in the law that loans must be made for working capital purposes, to established enterprises, for periods up to five years, the first is by far the most restrictive. Had it not been for this provision, we would have received more applications and could have approved some that were rejected during the past several years.

The present indefinite provisions of law as to ultimate disposition of funds received from the Treasury are very unsatisfactory. The same is true of the requirement that the Federal Reserve banks pay the Government annually 2 per cent, if earned, on the amount received from the Secretary of the Treasury. The provisions of the Mead-Ford Bill as to these particulars are very desirable.

The elimination of the requirement that each Federal Reserve bank shall have an Industrial Advisory Committee to pass upon all loan applications would simplify procedure and would therefore be helpful.

The proposed modification to provide that the participating financial institution must bear at least 10 per cent instead of at least 20 per cent of any loss that may be sustained would, of course, tend to induce financial institutions to participate in loans that would otherwise be made in their entirety by the Federal Reserve Bank; but the extent to which this would occur would depend in part upon the Reserve Bank's scale of commitment fees. It is also probable that this modification would bring in some applications that would not otherwise be filed. If this bank had assumed 90 per cent of the risk on every industrial loan it has made since 1934 and its income from industrial loans had been limited to small commitment fees, a substantial loss would have been incurred. As stated before, our whole program has resulted in a net loss of only $51,000; but this was due, in large part, to the fact that direct loans by the Federal Reserve Bank of Richmond far exceeded commitments, and the interest rate on all direct loans has been 6 per cent throughout the entire period.

Our directors and officers think Section 13b of the Federal Reserve Act would be improved materially by the passage of the Mead-Ford Bill.

SHOULD FEDERAL RESERVE BANKS MAKE INDUSTRIAL LOANS?

It could be argued, of course, that the making of direct loans to industry is entirely foreign to the purposes for which the Federal Reserve

System was established and that no funds of the Federal Reserve banks should be used for such a purpose. However, if the Mead-Ford Bill were passed, we would be lending funds not otherwise available without risk to the Reserve banks.

The industrial loan program of this bank has given our personnel useful experience and has supported an experienced staff in our Discount and Credit Department who may be of great future value in other forms of credit work.

It has been our experience that applications for industrial loans have increased only when business activity has declined, however, it may very well happen that the national defense program will cause increased demand for loans of this type in the near future. In our opinion, it would be highly desirable to have existing law changed to permit the assignment of claims on the United States.

Our directors and officers think it would be a mistake to make any effort at this time to terminate the power of Federal Reserve banks to make industrial loans.

CHAIRMAN JEROME FRANK'S PROPOSAL

As indicated in previous comments, we do not believe there is any legitimate need for term loans that could not be filled through ordinary channels, the Federal Reserve banks, or the Reconstruction Finance Corporation. The facts as to the legitimate need for equity capital on the part of small businesses are not so clear. We have been told by a senior officer of a large bank that he knows of several wealthy men who during the past year tried unsuccessfully to find suitable opportunities for such investments. While our own experience with small businesses has naturally been limited, we should not regard the common shares of the corporations which tried unsuccessfully to secure industrial loans from our bank during the past several years as desirable investments.

At the present time, issues under $100,000 are exempt from S.E.C. requirements. It would certainly be helpful if this exemption were raised, for issues of $100,000 or less are small.

While it is, of course, a matter of opinion, we think that, in so far as the Fifth District is concerned, a capital credit bank of the type Chairman Frank referred to in his Cleveland address would have a great deal of difficulty in selling its own common stock to the public. Much would depend on the general setup, the management, the degree of Government control, the rights of the preferred stock, provisions as to tax exemption, etc. It would not be easy to get the right men to serve on the board of directors, and it would be quite expensive to make thorough investigations of companies located in five states and the District of Columbia. If such a corporation were organized, it would probably be swamped with applications, most of which would have little merit. Thus, it is difficult to see how the corporation could secure any substantial volume of business without taking considerable risks, and how it could hope to make sufficient profits to create a demand for its stock without charging large fees, which is one of the principal things the proposal seeks to avoid.

Very truly yours,

ROBERT LASSITER,
Chairman of the Board.