Calendar No. 1037

72D CONGRESS
1st Session

SENATE

REPORT
No. 950

LOANS TO VETERANS

JUNE 28, 1932.—Ordered to be printed

Mr. SMOOT, from the Committee on Finance, submitted the following

REPORT

[To accompany S. 4569]

The Committee on Finance, to whom was referred the bill (S. 4569) relating to loans to veterans on their adjusted-service certificates, having considered the same, report it to the Senate without recommendation.

Following is a letter received by the chairman from the Administrator of Veterans' Affairs, dated June 16, 1932:

VETERANS' ADMINISTRATION,
Washington, June 16, 1932.

Hon. REED SMOOT,
Chairman Committee on Finance, United States Senate,
Washington, D. C.

MY DEAR SENATOR SMOOT: This is in reply to your letter of May 14, 1932, with which you forwarded for report a copy of S. 4569, Seventy-second Congress, a bill relating to loans to veterans on their adjusted-service certificates.

This bill would supersede portions of section 502 (c) and (d) of the World War adjusted compensation act, as amended, by providing for the decrease of the interest rate, charged a veteran to redeem a loan paid by the administration, from 6 per cent compounded annually to 3 per cent compounded annually. The provisions of this proposed bill would apply to all certificates redeemed by the administration from banks before, as well as *after*, the passage of this proposed measure, and the interest rate on such certificates would be reduced from 6 per cent to 3 per cent, from the date this proposed measure goes into effect.

Section 2 of this bill would supersede that portion of section 502 (1) of the act, as amended, which provides that an interest rate of not more than 4½ per cent compounded annually may be charged on direct loans made on and after February 27, 1931, by decreasing the interest rate to not more than 3 per cent compounded annually (1) on all loans made after the enactment of this bill into a law, and (2) on all administration loans made before the passage of this measure, such reduced rate to take effect from the passage of this measure. It would not apply to outstanding loans made by banks prior to the passage of this act.

Section 502 (c) of the original World War adjusted compensation act provided that if a veteran did not pay the principal and interest of a loan upon its maturity, the bank holding the note and certificate could, at any time after maturity of the loan but not before the expiration of six months after the loan was made, present them to the Director of the U. S. Veterans' Bureau who was authorized to redeem the loan and to hold the certificate until maturity or until any prior time upon receipt from the veteran of an amount equal to the sum of the amount paid by the United States to the bank in cancellation of his note, plus interest on such amount from the time of such payment to the date of such receipt, at 6 per cent per annum, compounded annually. Subdivision (d) of the same section provided that if the veteran failed to redeem his certificate from the director before its maturity, or before his death, the director could deduct from the face value of the certificate an amount equal to the sum paid to the bank on account of the note of the veteran, plus interest on such amount from the time of such payment to the date of maturity of the certificate or of the death of the veteran, at the rate of 6 per cent per annum, compounded annually.

The original World War adjusted compensation act permitted the veterans to secure loans on their adjusted-service certificates only from "any national bank, or any bank or trust company incorporated under the laws of any State, territory, possession, or the District of Columbia." It was not until the amendatory act of March 3, 1927, that the Director of the U. S. Veterans' Bureau was authorized to make loans to veterans upon their adjusted-service certificates from the United States Government life insurance fund. It was provided by that act at the rate of interest made from such fund should be 2 per cent per annum more than the rate charged at the date of the loan for the discount of 90-day commercial paper under section 13 of the Federal reserve act by the Federal reserve bank for the district in which the loan was made. The amendatory act of February 27, 1931, which increased the loan basis of adjusted service certificates to 50 per cent of the face value of such certificates provided that "in no event shall the rate of interest on any loan made after this subdivision takes effect exceed 4½ per cent per annum, compounded annually."

Since it is now possible to make direct loans at a rate of interest that does not exceed 4½ per cent per annum, compounded annually, there seems an inequality with the provision of the original law that authorizes the Government to charge 6 per cent on redeemed loans.

The situation has been somewhat relieved by a decision of the Comptroller General dated April 23, 1932, which held that as the law now stands interest at the rate of 6 per cent per annum, compounded annually, on all loans by banks made on or prior to February 27, 1931, and redeemed by the Government either prior or subsequent to that date, is required to be charged against the adjusted-service certificate of the veteran, and interest at the rate of 4½ per cent compounded annually, on all loans by banks made subsequent to February 27, 1931, and redeemed by the Government, is required to be charged against the adjusted-service certificate of the veteran. He further held that while the amendatory act of February 27, 1931, would not ipso facto reduce the rate of interest on existing unpaid loans, such act did not intend to prohibit the use of the recognized commercial practice of refinancing a prior loan by a subsequent loan in a greater amount. Hence, it is held proper to include the amount of an unpaid loan made prior to February 27, 1931, plus accrued interest at the rate of 6 per cent, in a loan made subsequent to that date for a greater amount under the terms of the amendatory act, and to charge interest at the rate of 4½ per cent, compounded annually, on the total amount. This latter practice has been in effect since the amendment in question.

This proposed measure makes provision for payment to the Government life-insurance fund out of the adjusted-service certificate fund of a sum sufficient to cover the difference in interest from the agreed amount to 3 per cent compounded annually. It is suggested that if the committee should give further consideration to this proposed measure, it should be amended to include a very clear provision that the Administrator of Veterans' Affairs be authorized to transfer from the adjusted-service certificate fund to the United States Government life-insurance fund a sum sufficient to cover the loss of interest by reason of the amendments from the effective date of the act, to the final date of the maturity of the loan. Attention also should be called to the necessity in the event of passage of such a bill, to provide for the reinvestment of the United States Government life-insurance fund, because of the fact that 3 per cent per annum, compounded annually, is not a fair return on the investment of that fund. The proposed bill fails to make any provision for this.

The World War adjusted compensation act provides (with certain limitations) that former members of the Military and Naval Establishments be credited with

$1 per day for service in the United States and $1.25 per day for service overseas, this basic credit to be increased by 25 per cent because of deferred payment, and the gross credit to be used as a net single premium for what is essentially in the nature of the purchase of a 20-year endowment insurance policy, computed according to the American experience table of mortality with interest at 4 per cent compounded annually. Thus it may be readily preceived that any reduction in the interest rate below 4 per cent would result, in effect, in the increasing of the amounts of the adjusted compensation as fixed in the original statute. It might at first appear, if a careful examination of collateral effects were not made, that the Government would profit because of making loans under the recent amendatory legislation at 4½ per cent interest; however, in fact, just the opposite result will likely obtain, as while it is true that some time ago the interest rate prevailing for Government issues was unusually low, it should be borne in mind that this represented only a temporary condition and that none of the funds so secured as a part of the general financing operations was specifically borrowed for the purpose of making loans on adjusted-service certificates, though of course the revision which was necessary for the Treasury to make in its financing plans because of the amendment to the adjusted compensation act of February 27, 1931, engendered the increasing by many hundreds of millions of dollars of the amount which had to be obtained through the sale of securities.

In view of the fact (1) that the effect on Government financing of the granting of loans on adjusted-service certificates in increased amounts, has been and is a decidedly adverse one, and (2) that the present rate of interest being charged is considered most reasonable, and (3) a change in the interest rate to 3 per cent per annum compounded annually would result in reduced earnings to the United States in the amount of $398,623,833 (the preceding figure is based upon approximate amount of loans outstanding at March 31, 1932, of $1,350,000,000), I feel constrained to recommend against favorable consideration of this proposed measure.

Although this bill has not been presented by this administration to the Director of the Bureau of the Budget, I wish to inform you that on a similar measure he stated that in view of the cost involved, it would not be in accord with the financial program of the President.

This administration can not recommend favorably regarding any further liberalization of the World War adjusted compensation act, as amended, at this time.

A copy of this letter is inclosed for your use.

Very truly yours,

FRANK T. HINES, *Administrator*.

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