Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date January 23, 1946.

To Chairman Eccles

Subject:

From Mr. Vest

In accordance with your request, I attach a brief summary of the more important powers and responsibilities of the Federal Reserve System in the field of credit.

GBV

Attachment.

RESUME OF STATUTORY RESPONSIBILITIES OF THE FEDERAL RESERVE SYSTEM IN THE CREDIT FIELD

The Federal Reserve System has a unique responsibility in the field of credit. The law gives to the Board of Governors, or to the Federal Open Market Committee, various functions in this field and they are alone responsible for the exercise of these functions. No part of this responsibility is given by the law to other agencies, and the views of any such other agencies cannot relieve the Board or the Open Market Committee of their responsibility for actions or failure to act in this field. The following is a brief resume of these statutory responsibilities.

Open Market Operations. - Under the law no Federal Reserve Bank may engage or decline to engage in open market operations except in accordance with the directions and regulations of the Federal Open Market Committee. The law further provides that the time, character and volume of open market operations shall be governed "with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country".

Discount Rates. - Federal Reserve Banks are authorized to establish discount rates subject to review and determination of the Board of Governors, and these rates "shall be fixed with a view of accommodating commerce and business". The Attorney General has held that the Board has the right to pass upon and fix discount rates established by Federal Reserve Banks, including the power to initiate such rates.

Margin Requirements. - The Board is given authority to prescribe rules and regulations with respect to credit extended on Stock Exchange securities, "for the purpose of preventing the excessive use of credit for the purchase or carrying of securities". It may prescribe lower margin requirements "for the accommodation of commerce and industry, having due regard to the general credit situation of the country", and may prescribe higher requirements "to prevent the excessive use of credit to finance transactions in securities".

Reserve Requirements of Member Banks. - The Board of Governors may change reserve requirements of member banks, within a limit of twice the percentages specified in the statute, and this may be done "in order to prevent injurious credit expansion or contraction". This power also is solely that of the Board of Governors and is to be exercised according to the Board's judgment as to whether credit expansion (or credit contraction) may prove injurious.

Suspension of Reserve Requirements. - The Board of Governors may suspend reserve requirements of Federal Reserve Banks or of member banks for periods not exceeding 30 days. While the law states no standard or criterion for such action, it is clear that the Board may take into consideration the credit situation and any other factors which it feels may affect the public interest. This power is, of course, not important at the present time but is nevertheless a statutory responsibility of the Board in the credit field.

<u>Reclassification of Reserve Cities</u>. - The Board may reclassify existing reserve and central reserve cities, either designating additional cities as such or terminating the designation of existing reserve or central reserve cities.

<u>Interest on Time and Savings Deposits</u>. - The Board is empowered to limit the rate of interest which may be paid by member banks on time and savings deposits. A similar power is vested in the FDIC with respect to nonmember insured banks.

<u>Speculative Use of Credit by Member Banks</u>. - Each Federal Reserve Bank must keep informed of the general character and amount of loans and investments of its member banks with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying of or trading in securities, real estate or commodities or for any purpose inconsistent with the maintenance of sound credit conditions. The Board may suspend a bank which is making such undue use of bank credit from the credit facilities of the Federal Reserve System. The Board is also authorized to fix for each Federal Reserve District the percentage of individual bank capital and surplus which may be represented by loans secured by stock or bond collateral; and the Board may forbid any member bank to increase its loans on stock or bond collateral under penalty of loss of its rediscount privileges.

<u>Thomas Amendment</u>. - There is another statutory provision that should be mentioned in this connection. A provision of the Thomas Amendment which is still in effect authorizes the Board, with the approval of the Secretary of the Treasury, to require the Federal Reserve Banks to take such action as may be necessary, in the judgment of the Board and of the Secretary, to prevent undue credit expansion. While this power requires joint action, it is of little practical importance in view of the other powers of the System above mentioned.

<u>Consumer Credit</u>. - In addition to the statutory responsibilities mentioned above, the Board also has authority under executive order of the President to regulate maturities and down payments in connection with consumer credit, in order "to assist in restraining general inflationary tendencies" and for related purposes. In exercising this function the Board is to take into consideration recommendations made by a committee of the Secretary of the Treasury, the Federal Loan Administrator and the OPA Administrator. Even here, however, responsibility for action is primarily that of the Board.

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