

Mr. Eells

January 19, 1951

Board of Governors

Voluntary program by financing

Mr. Vest

institutions for credit restraint.

Copies of the following documents are being submitted to each Board member pursuant to a discussion which I have had with Governor Powell and with the thought that the matter should be considered by the Board at its next meeting:

(1) "Program for Voluntary Credit Restraint" (marked Exhibit C), as agreed upon on January 15 at the meeting of the subcommittee of the A.B.A., investment bankers, and insurance companies.

(2) Letter of January 18 from Mr. Sproul expressing his views with respect to the Program and suggesting that the Board indicate whether it is prepared to approve the program.

(3) Minutes of the meeting of the subcommittee on January 15 at which the Program was agreed upon.

Attachments

GBV:lim

C O P Y

FEDERAL RESERVE BANK OF NEW YORK

New York 45, New York

January 18, 1951.

Board of Governors of the  
Federal Reserve System,  
Washington 25, D. C.

S i r s :

I enclose copies of the record of the meeting, at this bank in the afternoon of January 15, 1951, of the subcommittee of the Committee on Voluntary Credit Restraint which is proceeding under Section 708 of the Defense Production Act of 1950. As you know this subcommittee consists of representatives of the American Bankers Association, the Investment Bankers Association of America, and the Life Insurance Association of America. Copies of the record of the previous meeting of the subcommittee, on January 5, 1951, were transmitted to the Board with Mr. Treiber's letter of January 8, 1951.

Attached to the record of the January 5 meeting was a draft (marked "Combined Draft 1/5/51") of program containing a statement of principles. A revised draft of program (marked Exhibit C) is attached to the enclosed record of the January 15 meeting. As indicated in the record, the revision of the part of the program under the heading "Procedure for Implementing the Program" was drafted by lawyers representing the American Bankers Association, the Investment Bankers Association of America, and the Life Insurance Association of America who attended the meeting at the Board's office on January 9, 1951, with representatives of the Department of Justice and the Federal Trade Commission, and is designed to meet the suggestions made by the representatives of the Department of Justice at that time. I believe that both Mr. Vest and Mr. Logan who attended that meeting consider that the revised procedure does substantially meet those suggestions.

Changes were also made in the statement of principles. I attended the meeting of the subcommittee and when the statement of principles was reached for discussion I made some comments the substance of which is set forth in the record of the meeting. The changes in the statement of principles are in the direction of tightening it; in fact I think it is fair to say that they substantially meet the suggestions made in Governor Powell's letter of January 10 and the changes in phrassology which we suggested after studying the "Combined Draft of 1/5/51".

I feel that the statement of principles as agreed upon at the subcommittee meeting on January 15 and incorporated in the revised draft marked Exhibit C is reasonably satisfactory, particularly having in mind that this is a first experiment with a voluntary credit restraint program under the Defense Production Act. I am satisfied that most if not all those on the subcommittee feel that the statement can not be further tightened or made more specific without jeopardizing the prospect of getting the agreements of the organizations which it is intended will sponsor the program and of the concerns which are members of these organizations. In all this discussion continual references were made to the understanding that this was intended to be a voluntary program rather than one imposed by Governmental authority. As appears from the record I expressed my view that the effectiveness of the program depends more on the will and spirit of the interested parties to make it work, than upon the exact words used.

As you will note the revised program has not been submitted to the original parent committee which met on December 19, 1950, upon my invitation at the request of the Board of Governors. This is because the subcommittee felt that it was desirable to have some formal or informal indication that the program would be acceptable to the Board before the subcommittee submitted it to the parent committee. I feel also that it is desirable to submit the program to the Board for its consideration at this point.

Accordingly I suggest that the Board decide whether it is prepared, subject to the approval of the Attorney General, to approve the program in the form approved at the subcommittee meeting on January 15 and to request action pursuant to it; and, if the Board is prepared to approve this program, that it request me to call a meeting of the parent committee at which the subcommittee will present the program. If the Board is not prepared to approve the program, it should still request that a meeting of the parent committee be called, at which time, presumably, it would be prepared to inform the committee wherein the program falls short of its requirements. I assume that Governor Powell and Mr. Vest will attend the meeting of the parent committee, in either case.

Yours faithfully,

Allan Sproul,  
President.

Enclosures.  
WSL:WFT:AS:ms

January 15, 1951

At 3:00 o'clock p.m. this day there was held in the Federal Reserve Bank of New York a meeting of the subcommittee appointed by the committee on voluntary credit restraint under Section 708 of the Defense Production Act of 1950, consisting of representatives of the American Bankers Association, the Investment Bankers Association of America, and the Life Insurance Association of America.

Present:

American Bankers Association

George Champion, Senior Vice President,  
The Chase National Bank of the City of New York,  
New York, N. Y., and a member of the Subcommittee  
of the Credit Policy Commission of the American  
Bankers Association.

Kenton R. Cravens, Vice President,  
Mercantile-Commerce Bank and Trust Company,  
St. Louis, Missouri, and Chairman of the Credit  
Policy Commission of the American Bankers  
Association.

George S. Moore, Vice President,  
The National City Bank of New York, New York, N.Y.,  
and Chairman of the Subcommittee of the Credit  
Policy Commission of the American Bankers  
Association.

J. O. Brott, Assistant General Counsel,  
American Bankers Association.

Investment Bankers Association of America

Robert Craft, Vice President,  
Guaranty Trust Company of New York, New York, N.Y.  
Nevil Ford, Senior Vice President,  
First Boston Corporation, New York, N.Y..  
Murray Hanson, General Counsel,  
Investment Bankers Association of America.

Life Insurance Association of America

George L. Harrison, Chairman,  
New York Life Insurance Company, New York, N.Y.  
Carrol M. Shanks, President,  
Prudential Insurance Company of America,  
Newark, New Jersey.  
James J. O'Leary, Economist.  
Manuel Gorman, Assistant Counsel.

Board of Governors of the Federal Reserve System  
George B. Vest, General Counsel.

Federal Reserve Bank of New York  
Allan Sproul, President.  
Walter S. Logan, Vice President and  
General Counsel.  
William F. Treiber, Vice President.

(The subcommittee consists of Mr. Shanks,  
Chairman, and Messrs. Cravens, Moore, Craft,  
Ford and Harrison.)

Mr. Shanks reported that on January 9, 1951, Messrs. Brott, Gorman and Hanson had met at the offices of the Board of Governors of the Federal Reserve System in Washington with Governor Powell and Messrs. Vest and Logan, and with representatives of the Federal Trade Commission and of the Department of Justice, and had discussed the legal aspects of a voluntary agreement or program under Section 708 of the Defense Production Act of 1950. He stated that Messrs. Gorman and Hanson had reported to him that in the light of the discussion at that meeting they felt that it was necessary and desirable to revise the "Combined Draft 1/5/51" of memorandum which had been agreed to at the meeting of the subcommittee on January 5, 1951, so as to amplify considerably the portion thereof dealing with the procedure for implementing the program. Accordingly, he said, Mr. Sproul had informed the members of the parent committee which had appointed the subcommittee that the meeting of the parent committee, which Mr. Sproul had previously called for today, would be postponed until further notice pending a review of the procedural program and the preparation of a revised draft of memorandum by counsel and the subcommittee.

At Mr. Shanks' request, Mr. Gorman reported in greater detail on the meeting held in Washington on January 9, 1951.

Mr. Shanks stated that on January 10, 1951, the Joint Committee on Inflation Control of the Life Insurance Association of America and the American

Life Convention had approved a further revision of the Combined Draft 1/5/51 of memorandum agreed to at the last meeting of the subcommittee; and he presented to the meeting a copy of such further revision (hereinafter referred to as the "Draft of 1/10/51"). Copies were distributed among those present at the meeting; a copy is attached hereto, marked Exhibit A.

Mr. Shanks stated that the Draft of 1/10/51 had been prepared without the benefit of any suggestions by counsel in the light of the discussion at the meeting held in Washington on January 9, 1951. Accordingly, he said, the material contained in the Draft of 1/10/51 under the heading "Procedure for Implementing the Program" should be considered as obsolete.

The subcommittee then proceeded to review the preamble of the Draft of 1/10/51, discussing various provisions and making suggestions with respect thereto. Certain changes were agreed upon by the subcommittee.

Upon the completion by the subcommittee of its review of the preamble, Mr. Shanks suggested that the subcommittee then consider a draft of a rider prepared earlier in the day by Messrs. Brott, Gorman and Hanson, entitled "Procedure for Implementing the Program", to be substituted for that part of the Draft of 1/10/51 (at pages 2-4) under the heading "Procedure for Implementing the Program". Copies of the draft of rider (hereinafter referred to as the "Rider") were distributed among those present; a copy is attached hereto, marked Exhibit B. The subcommittee then proceeded to review the Rider, discussing various provisions and making suggestions with respect thereto. Certain changes were agreed upon by the subcommittee. It was understood that the two paragraphs comprising subdivision c beginning on page 3 of the Rider should be revised in certain respects, but the subcommittee felt that it was unnecessary to work out the exact language of the revision at the meeting; Messrs. Brott, Gorman and Hanson were requested to revise those two paragraphs after the meeting in the light of the views which had been expressed.

The subcommittee then resumed its consideration of the Draft of 1/10/51 beginning with the Statement of Principles, commencing at page 4 of such draft.

Mr. Sproul referred to the statement which he had made at the first meeting of the subcommittee, on December 28, 1950, that the principal concern of the Federal Reserve System with respect to any voluntary agreement or program that might be developed is (a) whether the agreement is likely to be effective in exercising some measure of restraint on credit expansion, and (b) whether the agreement is in such form that the Board of Governors of the Federal Reserve System, with the approval of the Attorney General, can properly request action pursuant to the agreement. As for the first question, he recognized the difficulties of getting agreement within and between the three groups represented in the subcommittee and in the parent committee, and that these difficulties are likely to increase the more specific and less general a statement of principles becomes. It was his personal view, he said, that making the program work depends not so much on the wording of any statement but, rather, on the will and spirit of interested groups to make it work and to observe the "rules". In reviewing the Combined Draft 1/5/51, he said, he had felt that it would be possible to tighten it without doing violence to these limitations by changes which would clarify what the subcommittee intended to say. He understood that some of the others who had been working on the draft had had a similar reaction. Indeed, the Draft of 1/10/51, which has been approved by representatives of the life insurance companies, has several tightening changes. He expressed the hope that the subcommittee would see its way clear to tighten up the final statement along these lines and if, out of the experience of its constituents, the statement can be made even more specific at any point, particularly with regard to unnecessary or inflationary loans, that would be helpful to the success of the whole program.

Mr. Shanks stated that he and Mr. Harrison had requested the technical men in their respective companies to study the entire problem of restraint of

credit, had reviewed a great number of their loans, and had concluded that it is impossible to write rules or principles that are any more specific than those contained in the Draft of 1/10/51. From their experience in this study they concluded that it is necessary to limit the statement to general principles. He felt that it would be impossible to put any more directives in the program and that, if the attempt were made, it would probably be impossible to get agreement. Mr. Ford stated that his company had made an analysis of recent securities issues and had come to the same conclusion as Mr. Shanks.

Reference was made to the fact that the Statement of Principles in the Draft of 1/10/51, in discussing permissible or appropriate extensions of credit, emphasizes in several places that the credit be for "essential" purposes. Thus the Draft of 1/10/51 is tighter in this respect than the Combined Draft 1/5/51. There was some discussion as to whether individual financing institutions should undertake to determine what is essential and what is not, or whether financing institutions should look to the Government for an indication as to what is essential. It was the consensus that in most cases financing institutions would be able to determine whether or not a proposed extension of credit is essential without waiting for or requiring an indication by the Government, and that they should undertake to do so within the limit of the information available to them.

The subcommittee then proceeded to review the Statement of Principles in the Draft of 1/10/51, discussing various provisions and making suggestions with respect thereto. Certain changes were agreed upon by the subcommittee. It was agreed that where reference is made in the Statement of Principles to loans and lending, this should include the flotation and distribution of securities by investment bankers. Messrs. Brott, Gorman and Hanson were asked to suggest some language to be inserted, perhaps in the preamble, which would make this clear.

Mr. Shanks said that, with certain changes which had been suggested at the meeting, the Draft of 1/10/51 was now acceptable to the subcommittee, it



being understood that counsel would suggest appropriate language to cover the points referred to above upon which the subcommittee had agreed in principle without perfecting the final wording. It was understood that Messrs. Brott, Gorman and Hanson would prepare a further revision of the Draft of 1/10/51 in the light of the discussion at the meeting and that copies of such revision would be furnished promptly to the members of the subcommittee, and that if any member of the subcommittee has any comments on such revision he should furnish them promptly to Mr. Shanks. It was understood that such revision would then be taken up with the Board of Governors of the Federal Reserve System and that, after receipt of such comments as the Board might have, a meeting of the parent committee would be held for the purpose of receiving the report by the subcommittee.

The meeting duly adjourned at 5:30 o'clock p.m.

William F. Treiber.

January 17, 1951

The further revision of the Draft of 1/10/51 prepared by Messrs. Brott, Gorman and Hanson pursuant to the understanding referred to in the next to the last paragraph of the foregoing record of the meeting of the subcommittee of January 15, 1951, was reproduced and furnished to the members of the subcommittee. A copy of such further revision is attached hereto, marked Exhibit C.

William F. Treiber.

PROGRAM FOR VOLUNTARY CREDIT RESTRAINT

Preamble

The task of restraining strong inflationary pressures is one of the most difficult and most important in the whole range of economic problems today.

One part of this task - the restraint of unnecessary credit expansion - presents a challenge to the financing institutions throughout the nation.

Section 708 of the Defense Production Act of 1950 authorizes the President to encourage financing institutions to enter into voluntary agreements and programs to restrain credit which will further the objectives of that Act. By executive order, the President has delegated to the Board of Governors of the Federal Reserve System his authority with respect to financing under this section of the Act upon the required condition that it consult with the Attorney General and with the Chairman of the Federal Trade Commission, and that it obtain the approval of the Attorney General before requesting actions under such voluntary agreements and programs.

At the invitation of the Board, and in company with it, representatives of the American Bankers Association, the Life Insurance Association of America and the Investment Bankers Association of America have been examining the possibilities of this method of credit restraint.

While it is recognized that the proposed program is addressed only to one limited source of inflationary pressure, the vital importance of this problem to the stability of the economy, and the necessity to extend credit only in such a way as to

restrain inflationary pressures outside the financing of the Defense Program should be emphasized to all financing institutions.

It is appropriate to point out that this program of voluntary credit restraint does not have to do with such factors as inflationary lending by federal agencies, unnecessary spending, federal, state or local, and the wage-price spiral and other much more seriously contributing factors. These should be vigorously dealt with at the proper places. It assumes that the proper governmental authorities will exercise the requisite fiscal and monetary controls.

#### Definitions

As used herein:

The terms "financing institution" or "financing institutions" mean banks, life insurance companies, investment bankers engaged in the underwriting, distribution, dealing or participating, as agents or otherwise, in the offering, purchase or sale of securities, and such other types or groups of financial institutions as the Board of Governors of the Federal Reserve System may invite to participate in the program.

The terms "loan", "loans", "lending" and "credit", in addition to their ordinary connotations, mean the supplying of funds through the underwriting and distribution of securities (either on a firm commitment, agency or "best efforts" basis), the making or assisting in the making of direct placements, or otherwise participating in the offering or distribution of securities.

### Statement of Principles

Pursuant to the provisions of Section 708(a) of the Defense Production Act of 1950, and with the approval of the Board of Governors of the Federal Reserve System in accordance with the functions delegated to it by Section 701(a)(2) of Executive Order 10161, this statement of principles has been drafted to which all financing institutions are asked to conform.

It shall be the purpose of financing institutions to extend credit in such a way as to help maintain and increase the strength of the domestic economy through the restraint of inflationary tendencies and at the same time to help finance the defense program and the essential needs of agriculture, industry and commerce.

Inflation may be defined as a condition in which the effective demand for goods and services exceeds the available supply, thus exerting an upward pressure on prices.

Any increase in lending at a more rapid rate than production can be increased exerts an inflationary influence. Under present conditions of very high employment of labor, materials and equipment, the extension of loans to finance increased output will have an initial inflationary effect; but loans which ultimately result in a commensurate increase in production of an essential nature are not inflationary in the long run whatever their temporary effect may be. It is most important, however, that loans for non-essential purposes be curtailed in order to release some of our resources for expansion in more vital areas of production.

Cooperation with this program of credit restraint makes it increasingly necessary for financing institutions to screen loan applications on the basis of

their purpose, in addition to the usual tests of credit worthiness. The criterion for sound lending in a period of inflationary danger boils down to the following: Does it commensurately increase or maintain production, processing and distribution of essential goods and services?

In interpretation of the foregoing, the following types of loans would be classified as proper:

1. Loans for defense production, direct or indirect, including fuel, power and transportation.
2. Loans for the production, processing and orderly distribution of agricultural and other staple products, including export and import as well as domestic, and of goods and services supplying the essential day-to-day needs of the country.
3. Loans to augment working capital where higher wages and prices of materials make such capital necessary to sustain essential production, processing or distribution services.
4. Loans to securities dealers in the normal conduct of their business or to them or others incidental to the flotation and distribution of securities where the money is being raised for any of the foregoing purposes.

This program would not seek to restrict loans guaranteed or insured, or authorized by a Government agency, on the theory that they should be restricted, in accordance with national policy, at the source of guaranty or authorization. Financing institutions would not be restricted in honoring previous commitments.

The following are types of loans which in general financing institutions should not make under present conditions, unless modified by the circumstances of the particular loan so as not to be inconsistent with the principles of this program.

1. Loans to retire or acquire corporate equities in the hands of the public, including loans for the acquisition of existing companies or plants where no overall increase of production would result.

2. Loans for speculative investments or purchases. The first test of speculation is whether the purchase is for any purpose other than use or distribution in the normal course of the borrower's business. The second test is whether the amounts involved are disproportionate to the borrower's normal business operations. This would include speculative expansion of real estate holdings or plant facilities as well as speculative accumulation of inventories in expectation of resale instead of use.

The foregoing principles should be applied in screening as to purpose on all loans on securities whether or not covered by Regulation U or T.

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Recognizing that the maximum estimate of the percentage of our 1951 production which will be devoted directly or indirectly to national defense is between 20% and 30%, a very substantial proportion of the lending of the country will be devoted to the financing of the production and growth of our industrial and commercial community. In these circumstances, it is felt that each financing

institution can help accomplish the objectives outlined above by careful screening of each application for credit extension.

In carrying out such screening, financing institutions should not only observe the letter of the existing regulations of the Board of Governors of the Federal Reserve System with respect to real estate credit, consumer credit, personal loans, security loans, etc., but should also apply to all their lending the spirit of these and such other regulations and guiding principles as the Government may from time to time announce in the fight against inflation.

This program is necessarily very general in nature. It is a voluntary program to aid in the overall efforts to lick inflation. To be helpful, this program must rely on the good will of all financing institutions and the overall intention to comply with its spirit.

#### Procedure for Implementing the Program

Pursuant to the provisions of Section 708(b) and (c) of the Defense Production Act of 1950, and upon full compliance with the terms and conditions thereof:

1. A "Voluntary Credit Restraint Committee" (hereinafter referred to as "the Committee") will be appointed by the Board of Governors of the Federal Reserve System (hereinafter referred to as "the Board"). Initially, the Committee will consist of twelve members, four representing the life insurance companies, four representing the investment bankers, and four representing the banks. The membership of the Committee may from time to time be expanded as deemed advisable or appropriate by

the Board to insure adequate representation thereon of other types or groups of financing institutions which may participate in the program as requested by the Board with the approval of the Attorney General. In selecting and appointing the members of the Committee, the Board shall have due regard to fair representation thereon for small, for medium and for large financing institutions, and for different geographical areas. The Committee will:

(a) With such assistance from the Board and the Federal Reserve Banks as may be necessary, distribute this statement of the program, including the statement of principles, to financing institutions;

(b) Appoint the subcommittees referred to below in 2;

(c) Meet for the purpose of considering the functioning of the program, advising the Board with respect thereto, and suggesting for the consideration of the Board such changes in the program, including the statement of principles, as may from time to time appear appropriate. Meetings of the Committee shall be held at the call of an official of the Federal Reserve System, designated by the Board; shall be under the Chairmanship of such an official; and an agenda for such meetings shall be prepared by such an official. Full and complete minutes of each meeting shall be made by such an official and copies shall be kept in the files of the Board available for public inspection.

2. Subcommittees may be established for each type of financing institution participating in the program. For the investment bankers, the life insurance companies, and the banks there may in each case be a single subcommittee organized on a national basis and/or regional subcommittees. The subcommittees will be available for consultation with individual financing institutions to assist them in determining the application of the statement of principles with respect to specific loans



for which application has been made to such financing institutions. In consulting with a subcommittee, a financing institution shall not be required to disclose the identity of the applicant for any loan. No financing institution shall be required to consult with any subcommittee with respect to any loan or loans, or any application or applications therefor. Consultation with a subcommittee shall be wholly within the individual and independent discretion of a financing institution. The final decision with respect to making or refusing to make any particular loan or loans shall likewise remain wholly within the individual and independent discretion of each financing institution, whether or not it has consulted with any of the subcommittees.

In setting up the subcommittees, the Committee shall have due regard for fair representation thereon for small, for medium and for large financing institutions, and for different geographical areas. It shall also inform the Board of all subcommittee appointments.

3. The Committee shall be furnished with such compilations of statistical data on extension of credit by financing institutions as may be required to show the amounts and direction of credit use and to watch the operation of the program. Such statistics shall be compiled by the Board. To assist the Board in making such compilations, data shall be supplied for the investment bankers, jointly by the Investment Bankers Association and the National Association of Securities Dealers, and for the life insurance companies, jointly by the Life Insurance Association of America and the American Life Convention. Data furnished

to and compilations made by the Board shall not reveal the identity of individual financing institutions or borrowers. Such compilations shall be kept on file with the Board and shall be available for public inspection.

4. Financing institutions will keep records of individual loans, as to purpose, in such form as to be available for future analysis.

5. Any change in the program, including the statement of principles, shall be passed upon by the Committee and approved by the Board and the Attorney General before being put into effect.

All actions pursuant to and under the program will be automatically terminated by all participating financing institutions as of the termination of the authority conferred under Section 708 of the Defense Production Act of 1950; or upon withdrawal by the Board of its request for action under the program. If the Committee, after study of the operation of the program, concludes that it is no longer necessary or is not making a substantial contribution to the solution of the problem for which the program was established, it shall so advise the Board.