For release on delivery

Statement by

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Governor, Board of Governors of the Federal Reserve System

before the

Committee on Banking, Currency and Housing

House of Representatives

May 12, 1975

I am pleased to meet with this Committee to present the views of the Board of Governors of the Federal Reserve System on H.R. 6676. This bill would establish a program of mandatory reporting on the volume of commercial bank credit channeled to various categories of credit that are designated as national priority uses. It raises serious and complex issues that extend to the fundamental structure of our economic system and our nation's primary reliance on market processes to resolve the allocation of credit among competing uses.

The stated purpose of the bill is "to maximize the availability of credit for national priority uses." Although the bill does no more than establish a mandatory reporting system at this time, it could facilitate later efforts to impose mandatory credit controls and, by the force of what is perceived as Congressional intent, might well influence current lending policies at banks. In any event, the bill is likely to be construed by the market as a first step in the direction of a credit allocation program that could ultimately supplant the decision-making processes of the private market. In the Board's view, moving in this direction would represent a grave error, for no good substitute has been found for our highly developed and intensely competitive private financial markets in distributing credit resources.

Any governmental program for allocating credit on a priority basis at commercial banks would be subject to serious problems. There is, first of all, the fundamental question of choosing which specific credit uses should be accorded a "national priority" designation and which should be denied it. Second, borrowing at banks--which is all that is covered by this bill--represents only one, highly variable, part of the total flow of credit being channeled into various uses by our financial system. For example, over the last five years banks have provided, on average, about three-eighths of total nonfinancial funds raised in our credit markets. Furthermore, many customers who have borrowed from banks also have ready access to other sources of credit. Thus, if a particular customer, or class of customer, were to be denied access to bank credit, he might well be able to obtain funds in the open market or from other institutional lenders.

On first glance, it might seem that if certain bank customers were to be diverted to the market, more funds would be left in the bank for lending to higher-priority users or to those who do not have access to nonbank sources. However, banks must compete in the market for funds, like anyone else. To the extent that former bank customers would also turn to the open market for financing, interest rates would tend to rise, raising the cost of funds to banks and reducing their willingness to lend, except at higher loan rates and on stiffer nonprice terms. Thus, looking at the results in credit markets as a whole, designated priority credit users at commercial banks might well find that the cost of funds has risen and the availability has become limited.

Efforts to deal with these shortcomings would ultimately require a credit control program going beyond the banks to encompass all suppliers of funds. Such a comprehensive credit control program is just not feasible in this country, at least in peacetime. Controls would need to include not only banks but also other institutional lenders, such as mutual savings banks, savings and loan associations, finance companies, insurance companies, and pension funds. The open markets for debt and equity securities would need to be covered, not to mention the network of trade credit. Moreover, borrowers' access to credit obtained from abroad would have to be regulated.

Any attempt to impose a comprehensive credit allocation program would disrupt the orderly processes of financial markets, and could well lead to imbalances in the markets for goods and services. The present bill, of course, does not establish such a program. The basic difficulty, however, is that market participants may come to believe that it will lead to over-all, mandatory credit controls or, at a minimum, to controls on banks alone. When and as this conviction becomes strong among private borrowers, they would be likely to protect themselves by borrowing substantial sums in anticipation of their future credit needs. Such actions would tend to exert upward pressure on interest rates and work to the disadvantage of borrowers with limited flexibility--such as homebuyers, small businesses, and consumers.

Given the possibility that this bill will be interpreted as a step in the direction of mandatory credit allocation, the Board believes that the bill should not be enacted. To the extent that the collection of information on credit uses from commercial banks is necessary, the Board believes that it should continue to be on a voluntary basis.

The Board has already been collecting some credit use information from a sample of about 125 large banks. The initial survey was undertaken in January of this year, and was designed to determine how banks had adapted their lending policies in light of a statement issued by the Federal Advisory Council in September 1974. I have attached a summary of responses to the initial survey for the Committee's information.

The initial survey showed that banks continued to respond to the expressed credit needs of businesses, homebuilders, and individuals. The number of loan requests for financial or speculative purposes had dropped off to a much lower level than usual, and 90 per cent of the banks reported that they had approved either none at all, or a significantly smaller-than-normal proportion, of such applications.

The Federal Advisory Council's statement was issued during a period of monetary restraint, and economic and financial conditions have, of course, changed considerably since. A second survey, on which we made some modifications in light of experience with the first survey, was conducted in April. (A copy of that revised survey form is also attached.) We do not have a complete tabulation of responses yet, but I can report that about three-fifths of the respondents in our latest survey found that problems of allocating credit at their individual banks were significantly less than in the fall of last year. In the January 1975 survey only one-third had so indicated. Allocation of credit among competing creditworthy borrowers is clearly fading as a problem at our banks, reflecting both the larger inflows of funds and the smaller over-all demands for credit that they are now experiencing.

The banks surveyed have cooperated very well in these two surveys. In developing the questions for these surveys, the Board has had to take into account the practical availability of information at banks and the desirability of avoiding heavy administrative and cost burdens. Most of the material obtained has been qualitative rather than quantitative in nature, because the banks simply are unable to provide actual dollar figures without reviewing and reclassifying all of their loans. That would be a very costly process.

The Board could, of course, revise the questionnaire to seek quantitative data on a voluntary basis, should the Congress so direct. But it must be kept in mind that the resulting information--

though appearing to be hard numbers--might not be of much value for the public purposes being sought.

Our long experience in data collection indicates that it is difficult to define lending catagories that can be related in a meaningful way to customer uses of the funds borrowed. Money is an all-purpose commodity. Virtually all borrowers have funds that become available from a variety of sources and make expenditures for a variety of purposes. It is difficult to sort these various sources and uses of funds into particular pockets, even when both borrowers and lenders have the best of will. But when one kind of credit use is indicated to be preferred over another, both parties to the loan transaction will tend to take advantage of the fungibility of money to classify the purpose as being for the preferred use.

This is a shortcoming of any purpose system of loan classification. But the loan classifications for indicated priority uses contained in this bill involve other difficult definitional and interpretive problems as well. In many cases, for example, the definitions could be interpreted as involving the need for subjective judgments on the part of banks--such as deciding which loans represent funds for "essential structures and equipment" or "uses essential to orderly functioning of markets." These judgments would be likely to differ bank by bank, so that the reported results could mean little in the aggregate. Moreover, if the banks utilize national priority categories as a basis for discriminating among borrowers, the subjectivity of interpretation could lead to inequitable treatment of borrowers as some banks apply stricter standards than others.

There is also a practical problem at this moment--H.R. 6676 might adversely affect the urgently needed economic recovery. The bill's mandated questionnaire on national priority uses of credit, under current circumstances, could have counter-productive effects in terms of stimulating economic recovery. It would create uncertainties at banks as to interpretation. It would run the risk that some banks, already in a cautious frame of mind, might hold back on approving some otherwise sound credits for fear that they might be inconsistent with the priority scheme.

Thus, it is doubtful, in the Board's view, whether such a survey of credit allocation is desirable at this time, when private credit demands on banks are extremely weak and monetary policy is attempting to stimulate economic recovery. Indeed, the results of the Board's two voluntary surveys of bank lending policies suggest that there is little or no further economic and financial need for such surveys under prevailing circumstances.

For the various reasons I have noted, the Board is unable to support this or any other bill related to mandatory reporting of bank credit accommodation along explicit or implied priority lines. The Board as a general matter believes that if any information on credit use is to be collected, it should be done on a voluntary basis and tailored to what a voluntary reporting effort would support in order to minimize possibilities of market misinterpretation. If Congress nevertheless feels that it is essential to pass this kind of legislation, the Board would strongly suggest that the categories not be termed "national priority uses of credit," because this could, under current circumstances, discourage some lending and in that degree retard economic recovery.

Survey of Bank Response to Federal Advisory Council Statement on Lending Policies

In January of this year a questionnaire on lending policies was sent to a panel of 125 large commercial banks. This questionnaire was designed to ascertain bank response to the statement on bank lending policies issued by the Federal Advisory Council in September 1974 (see Sept. BULLETIN, pp. 679–80). The survey results are summarized in Tables 1 and 2.

Most of the banks indicated in their responses that they either had transmitted the FAC statement directly to their loan officers or had issued specific guidelines to implement the policies discussed in the statement. And a number of banks reported that they had previously issued similar policy lending guidelines of their own to loan officers.

TABLE 1

Bank responses to credit allocation questions, December 1974 compared with same month in preceding years

Number of banks; Figures in parentheses indicate percentage distribution of total banks reporting

Item	Total number of banks[1]		Significantly larger		Essentially unchanged		Significantly smaller		None received		None approved	
Urgency of credit allocation as compared with mid-Sept. 1974	123	(100.0)	8	(6.5)	74	(60.2)	41	(33.3)	....		....	
Purpose and nature of loans:												
To meet basic credit needs for normal operations—												
Applications received	123	(100.0)	26	(21.1)	81	(65.9)	16	(13.0)	....		....	
Proportion approved	123	(100.0)	9	(7.3)	101	(82.1)	13	(10.6)	....		....	
To finance capital investment—												
Applications received	123	(100.0)	26	(21.1)	67	(54.5)	30	(24.4)	....		....	
Proportion approved	123	(100.0)	12	(9.8)	95	(77.2)	16	(13.0)	....		....	
To businesses suffering temporary illiquidity—												
Applications received	123	(100.0)	63	(51.2)	49	(39.8)	4	(3.3)	7	(5.7)	....	
Proportion approved	123	(100.0)	36	(29.2)	75	(61.0)	4	(3.3)	....		8	(6.5)
To finance homebuilding industry—												
Applications received	123	(100.0)	5	(4.1)	24	(19.5)	94	(76.4)	....		....	
Proportion approved	123	(100.0)	6	(4.9)	75	(61.0)	42	(34.1)	....		....	
To individuals for basic household needs and autos—												
Applications received	123	(100.0)	8	(6.5)	29	(23.6)	86	(69.9)	....		....	
Proportion approved	123	(100.0)	9	(7.3)	77	(62.6)	37	(30.1)	....		....	
For purely financial activities—												
Applications received	123	(100.0)	1	(0.8)	29	(23.6)	55	(44.7)	38	(30.9)	....	
Proportion approved	123	(100.0)	0	(0)	13	(10.6)	33	(26.8)	....		77	(62.6)
For speculative purposes—												
Applications received	123	(100.0)	1	(0.8)	26	(21.1)	74	(60.2)	22	(17.9)	....	
Proportion approved	123	(100.0)	0	(0)	9	(7.3)	40	(32.5)	....		74	(60.2)

[1]Two banks on the original panel of 125 had merged with other banks, but all of the 123 other members of the panel responded to the survey.

The banks in the survey panel were asked to evaluate the urgency of credit allocation in December 1974, as compared with the situation prevailing in September when the FAC statement was issued. Whereas two-thirds of the respondents indicated that the situation had not changed significantly, one-third of the banks did report that the problem of allocating available funds among their various types of credit demand was significantly less urgent.

In order to evaluate both the pattern of demands for bank credit and bank attitudes toward credit requests, the survey respondents were asked a series of qualitative questions on the trends in numbers of loan applications and the proportion of such requests approved in December 1974, as compared with the normal experience during that month in recent years. For certain types of loans that ordinarily represent only a small proportion of amounts outstanding—such as loans for temporary liquidity needs, for purely financial purposes, or for speculative operations—the banks were also asked to indicate whether they had had any such loan applications during the report month.

In interpreting the replies, which are summarized in Table 1, it should be recognized that credit availability at banks was more restrictive in December 1974 than it had been on the average in that month during preceding years. Thus, as shown in that table there was a larger than usual number of applications from businesses suffering a temporary lack of liquidity. Despite the tighter conditions, 90 per cent of the banks either approved as many requests as usual or approved a significantly larger number. With regard to loans for purely financial or speculative purposes, on the other hand, about 90 per cent of the banks approved either a smaller proportion of requests or none at all.

Table 2 gives aggregate data on the changes in amounts outstanding in certain key loan categories. It should be noted that the changes in outstandings reflect loan repayments and takedowns of loan commitments that may have been made prior to the survey period, as well as new loans for which applications were received or processed during the period covered by the questionnaire.[1] The statistical summary also compares the change in bank loans to foreigners with the change in funds obtained from foreign sources during the period. For the banks covered by the sample, funds obtained from foreigners increased sharply whereas outstanding loans to foreigners actually declined.

TABLE 2

Loans outstanding: Changes in selected categories (October 16, 1974–January 15, 1975)

Amounts in millions of dollars

Loan category	Change in— Amount	Change in— Per cent
Commercial and industrial loans adjusted[1]	744.3	.73
Real estate loans secured primarily by residential properties plus residential construction loans included in commercial and industrial loans	297.7	.97
Loans to nonbank financial institutions	−25.1	−.09
Finance companies	354.1	3.97
Other	−379.1	−1.85
Loans to individuals	−126.4	−.45
Net change in claims on foreigners	−2,523.4	−18.44
MEMO:		
Loans to foreigners[2]	−747.0	−6.02
Due to foreigners[3]	1,776.4	6.81

[1]Excluding residential construction loans and loans to foreign businesses (data partly estimated).

[2]Loans to foreign businesses plus loans to foreign commercial banks, foreign governments, and foreign official institutions.

[3]Demand and time deposits due to foreign banks, foreign governments, foreign official institutions, and foreign individuals, partnerships, and corporations (data partly estimated), plus gross liabilities to their own foreign branches.

[1]The time period covered was the 3-month period from October 15, 1974, to January 15, 1975, to be consistent with the intended quarterly timing of the survey and to avoid possible distortions arising from window-dressing arrangements at the year-end statement date.

FR 977
OMB No. 55R0260
Approval Expires January 1976

QUARTERLY SURVEY OF BANK POLICIES WITH RESPECT TO CREDIT USE

March 1975

On September 16, 1974, the Board of Governors of the Federal Reserve System mailed to each member bank a statement on bank lending policies developed by the Federal Advisory Council (FAC) suggesting how banks could effectively adapt lending policies in a period of credit restraint. Banks are being surveyed quarterly to determine how their lending policies and activities correspond with that statement.

Because economic and financial conditions have changed since September, certain modifications have been made in the present questionnaire. The questionnaire should be completed by a senior officer familiar with the bank's lending practices in the areas covered. Please return one copy of the completed report by April 30, 1975 to:

Banking Section
Federal Reserve Board
Washington, D.C. 20551

I. Either because of changes in credit demands, changes in fund availability, or changes in the over-all economic situation, how would you evaluate the urgency of credit allocation at your bank as compared with the situation prevailing in mid-September 1974, when the FAC statement was published (check one)—

Significantly greater	☐	(1)
Essentially unchanged	☐	(2)
Significantly less	☐	(3)

II. Questions relating to the specific loan policies outlined in the FAC statement. Please check the appropriate box in both parts "a" and "b" for each question.

1. With respect to *loans to meet basic credit needs for normal operations of established domestic business customers* —

   a. Was the number of applications or requests for such loans or loan commitments received during March, as compared with the usual experience for the same month in recent years—

Significantly larger	☐	(1)
Essentially unchanged	☐	(2)
Significantly smaller	☐	(3)

   b. In processing applications for loans of the types covered in "a" above, was the proportion approved in March

Significantly larger than usual	☐	(1)
Essentially unchanged	☐	(2)
Significantly smaller than usual	☐	(3)

2. With respect to *loans to domestic customers to finance productive capital investment in structures and equipment*—

a. Was the number of applications or requests for such loans or loan commitments received during March, as compared with the usual experience for the same month in recent years

Significantly larger	☐	(1)
Essentially unchanged	☐	(2)
Significantly smaller	☐	(3)

b. In processing applications for loans of the types covered in "a" above, was the proportion approved in March

Significantly larger than usual	☐	(1)
Essentially unchanged	☐	(2)
Significantly smaller than usual	☐	(3)

3. With respect to *loans to basically sound, established domestic businesses suffering temporary lack of liquidity*

a. Was the number of applications or requests for such loans or loan commitments received during March, as compared with the usual experience for this period in recent years

Significantly larger	☐	(1)	Significantly smaller	☐	(3)
Essentially unchanged	☐	(2)	None received	☐	(4)

b. In processing applications for loans of the types covered in "a" above, was the proportion approved in March

Significantly larger than usual	☐	(1)	Significantly smaller than usual	☐	(3)
Essentially unchanged	☐	(2)	None approved	☐	(4)

4. With respect to *construction loans for residential purposes**

a. Was the number of applications or requests for such loans or loan commitments received during March as compared with the usual experience for the same month in recent years

Significantly larger	☐	(1)
Essentially unchanged	☐	(2)
Significantly smaller	☐	(3)

b. In processing applications for loans of the types covered in "a" above, was the proportion approved in March

Significantly larger than usual	☐	(1)
Essentially unchanged	☐	(2)
Significantly smaller than usual	☐	(3)

* Please include in your answer, to the extent possible, the activities of your mortgage finance subsidiaries and affiliates.

5. With respect to *loans for permanent mortgage financing for residential property**—

a. Was the number of applications or requests for such loans or loan commitments received during March as compared with the usual experience for the same month in recent years

Significantly larger	☐	(1)
Essentially unchanged	☐	(2)
Significantly smaller	☐	(3)

b. In processing applications for loans of the types covered in "a" above, was the proportion approved in March

Significantly larger than usual	☐	(1)
Essentially unchanged	☐	(2)
Significantly smaller than usual	☐	(3)

6. With respect to *loans to individuals extended to meet their basic consumer credit requirements*—

a. Was the number of applications or requests for such loans or loan commitments received during March as compared with the usual experience for the same month in recent years

Significantly larger	☐	(1)
Essentially unchanged	☐	(2)
Significantly smaller	☐	(3)

b. In processing applications for loans of the types covered in "a" above, was the proportion approved in March

Significantly larger than usual	☐	(1)
Essentially unchanged	☐	(2)
Significantly smaller than usual	☐	(3)

7. With respect to *loans to domestic customers for purely financial activities that do not entail reasonable prospect of an improvement in the nation's productive capacity, such as acquisitions or the purchase of a company's own shares* —

a. Was the number of applications or requests for such loans or loan commitments received during March as compared with the usual experience for the same month in recent years

Significantly larger	☐	(1)	Significantly smaller	☐	(3)
Essentially unchanged	☐	(2)	None received	☐	(4)

b. In processing applications for loans of the types covered in "a" above, was the proportion approved in March

Significantly larger than usual	☐	(1)	Significantly smaller than usual	☐	(3)
Essentially unchanged	☐	(2)	None approved	☐	(4)

8. With respect to *loans to domestic customers for speculative purposes, such as purchasing securities or commodities other than in the ordinary course of business beyond what is required for the orderly functioning of markets, or investing in land without well-defined plans for its useful development* —

a. Was the number of applications or requests for such loans or loan commitments received during March, as compared with the usual experience for the same month in recent years

Significantly larger	☐	(1)	Significantly smaller	☐	(3)
Essentially unchanged	☐	(2)	None received	☐	(4)

b. In processing applications for loans of the types covered in "a" above, was the proportion approved in March

Significantly larger than usual	☐	(1)	Significantly smaller than usual	☐	(3)
Essentially unchanged	☐	(2)	None approved	☐	(4)

III. Memorandum items. With respect to each of the items listed below, please report the dollar amounts outstanding (to the nearest thousand) for the date specified. These items generally relate to specific loan categories in Schedule A of the Call Report or in the Weekly Report of Condition, and the footnotes identify the applicable line numbers in those Reports.

	AMOUNT OUTSTANDING (In thousands of dollars) April 15, 1975
1. Commercial and industrial loans 1/	
a. Loans for residential construction included in above 2/	
b. Loans to foreign businesses included in above 3/	
2. Real estate loans secured primarily by residential properties 4/	
a. Loans for construction included in above	
3. Loans to nonbank financial institutions 5/	
a. Finance companies 6/	
b. Other 7/	
4. Loans to individuals 8/	
5. Loans to foreign commercial banks, foreign governments and foreign official institutions 9/	
6. Foreign claims.	
a. Demand and time deposits due to foreign banks, foreign governments, and foreign official institutions 10/	
b. All other deposits 11/	
c. Gross liabilities to own foreign branches 12/	

1/ Weekly Report of Condition, item 2(h).

2/ For those banks that file the 416a (Commercial and Industrial Loans by Industry), construction loans are reported separately as a line item in that report. But for the purposes of memorandum item 1a in this survey, include *only* residential construction loans. If the data are not readily available, please estimate. For those banks that do not file the FR 416a, please make estimates of this item.

3/ For those banks that file the 416a, these loans are reported separately as a line item in that report. For those banks that do not file the 416a, please estimate.

4/ Call Report, Schedule A, items 1(b) and 1(c). If necessary, please estimate as of current survey report date indicated above.

5/ Weekly Report of Condition, item 2(d).

6/ Weekly Report of Condition, item 2(d) (1).

7/ Weekly Report of Condition, item 2(d) (2).

8/ Call Report, Schedule A, item 6. If necessary, please estimate as of current survey report date indicated above.

9/ Weekly Report of Condition, items 2(c) and 2(j) (1).

10/ Weekly Report of Condition, items 7(d), 7(g), 8(e), and 8(h).

11/ All other foreign demand and time deposits not included in Memorandum item 6a above, i.e., deposits of individuals, partnerships, and corporations. If data are not readily available, please estimate.

12/ Total dollar amounts due by all offices of the reporting bank in the states of the United States and the District of Columbia to the reporting bank's own branches located outside all of the following: the states of the U.S., the District of Columbia, the Commonwealth of Puerto Rico the U.S. Virgin Islands, the Canal Zone, American Samoa, and Midway, Wake, or Guam Islands. Include in this total, sale of assets under repurchase agreements to own foreign branches. All liabilities should be reported gross, not offset by claims on foreign branches.

Signature

Title

Name and address of bank