



FEDERAL RESERVE BANK  
OF DALLAS

Circular No. 45  
Series of 1920

December 15th, 1920.

CREDIT CONDITION AND LOAN POLICY

TO THE OFFICERS AND DIRECTORS  
OF THE MEMBER BANK ADDRESSED—

GENTLEMEN:

At its last meeting our Board of Directors made a careful review of the credit and financial situation in this District and the future policy of this bank was the subject of considerable discussion and was given full and thorough consideration.

Following the discussion I was authorized and instructed to communicate to the member banks of the District the consensus of the views of the Directors, which action seems timely and appropriate as we are just entering upon a new year.

It must be understood that we are fully aware of the fact that many banks receiving this letter have their affairs in sound and liquid condition, requiring no special admonition at our hands, but it is hoped that the views expressed herein are so sound and helpful that they may be of some benefit to all our banks.

We believe that the financial condition of the District is intrinsically sound, although the heavy decline in the prices of practically all products makes it necessary to somewhat readjust business to meet these changed conditions.

In bringing about this readjustment we consider it indispensably necessary, and a matter of first importance, that all banks shall limit their loans to producing businesses and enterprises, absolutely declining all merely speculative loans and reducing to a minimum loans of an investment nature. It appears equally essential that all banks having rediscounts or owing borrowed money should immediately take effective steps to secure liquidation for, although we are in the midst and nearing the end of the period when our seasonal liquidation normally takes place, we are now carrying an unduly large amount of rediscounts and loans for our member banks, many of whose lines show little or no diminution from the maximum amount reached during the summer. Bearing this in mind, and also the fact that within a short while the banks will be called on for funds for crop planting and for other seasonal needs, it seems proper to suggest to the banks that, before making commitments for the new year, they should give careful attention to the above suggestions as well as consideration to their ability, within their own resources, to take care of any and all loans made without resorting to excessive borrowing from the Federal Reserve Bank.

Section 4 of the Federal Reserve Act directs that in extending discounts, advances and accommodations to any one member bank, due regard must be had for the claims and demands of all other member banks. This provision should always be borne in mind by member banks for, under a rigid enforcement of this rule, the maximum limit of discount accommodation to any member bank would be in an amount substantially equal to two and one-half times the reserve of such member bank plus two and one-half times the amount of its paid-up capital stock in the Federal Reserve Bank.

We have not heretofore found it necessary to make this measure of borrowing the limit or rule in this bank, but if it becomes necessary to limit borrowings by our member banks we shall not hesitate to do so.

At the beginning of the present year many banks, in making their commitments, failed to give proper consideration to the fact that their unusually large deposits would prove unstable, and made loans with less conservatism than sound business prudence would suggest, with the result that they found themselves compelled to rediscount with us far more heavily than should have been necessary. In many of the banks too large a portion of their funds became tied up in investment loans and too frequently in loans for speculative purposes. This policy should and must absolutely cease, and banks should not and must not make such loans with the expectation that funds with which to carry them may be obtained by rediscounting with us. The course of safety lies in granting credits only for productive purposes, and then only in conservative amounts.

We have repeatedly attempted to impress on our member banks the fact that they should not consider this bank a mere source of supply for loanable funds to permanently increase their lending ability, but that the rediscount privilege should be held in reserve for temporary emergencies, or to meet unusual demands of a legitimate and strictly seasonal character. Such was the primary purpose of our rediscount facility.

It seems important that this fact should be emphasized and member banks are urged to bear it in mind in shaping their loan policy during the coming year. They should limit their offerings to us to the lowest amount possible and send us only such paper as there is reason to believe will be actually retired at its maturity.

We have no power to control the interest rates charged their customers by our member banks, but we do feel that when you are called upon to make loans out of your own resources, for essential and productive purposes, those loans should not be burdened by an increased rate simply to give your bank a margin of profit, should it become necessary for you to rediscount with us.

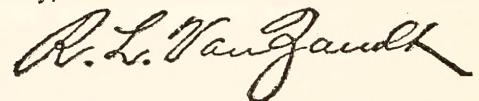
Again, it seems worth while to call attention of our member banks to what seems to be a practice too generally adopted by many of them of borrowing heavily and continuously against Government securities. The rates heretofore adopted by our Board on notes secured by this class of security has undoubtedly encouraged the practice mentioned. While we regard an obligation of the United States as the best security in the world, it must nevertheless be remembered that a loan by us against such securities uses up just as large a part of our resources as if secured by commercial paper, or live stock, or farm products. It seems timely, therefore, to suggest payment or reduction in all such loans wherever at all possible.

With courage to meet the future and a firm determination to do our part, let us all resolve to get our feet down to earth, and plan to build wisely for the future. It does not need to be said that we shall be quick and eager to render any assistance reasonably within our power to those banks which need and are entitled to same. But, by all means let's get all of our banks out of the "brokerage house" class and bring them back to their rightful and proper status of conservative banking institutions. As an indispensable precedent to this condition there must be a practically complete cessation of loans except for legitimate production and essential commercial needs, coupled with an orderly, determined, but not unnecessarily drastic, liquidation.

Such a policy generally and resolutely adopted and persevered in will, in a comparatively short time, work a wonderful change in this District. There are latent powers of liquidation in each community which can be discovered, which when worked out will reasonably insure not only safety to the bank, but credit availability for all legitimate demands.

Our Board earnestly requests that you read this letter to your Directors at their next meeting and that you write us their opinion of the views outlined and suggestions made herein.

Respectfully,

A handwritten signature in dark ink, appearing to read "R. L. Van Zandt". The signature is fluid and cursive, with a large, stylized initial "R" and a long, sweeping tail that extends to the right.

Governor.