

FEDERAL RESERVE BANK  
OF DALLAS

August 25, 1924.

EXCESS LOANS

To the Member Bank Addressed:

From time to time we receive requests from our member banks for suggestions in connection with the problem of dealing with applications for unusually large lines of credit. In order that our views on this subject may be thoroughly understood by all member banks, we are presenting them herewith in the form of a general letter to our members.

It is assumed that the provisions of federal and state laws relating to the limits within which member banks may make advances to a single borrower are well understood. It should be borne in mind, however, that these laws were intended to serve only as a legislative declaration of the maximum limits within which certain classes of loans should be restricted as a matter of public policy, based upon general banking experience, and were in no wise to be construed as lending sanction or encouragement to the full use of these limits whenever applied for, unless the maximum advance be justified by all the conditions surrounding the loan.

Loans which exceed the legal loan limit usually fall into two classes: (1) capital loans, and (2) loans to exceptionally large enterprises. The former include loans to under-capitalized industries or businesses which operate on a large scale and whose margin of profit is of such a narrow or speculative character as to make it difficult for them to obtain credit outside of their immediate communities. On the other hand, excess loans are often made to strongly capitalized firms doing a substantial manufacturing or commodity business in a community having relatively small banking resources. Such concerns often fail to utilize the outside sources of credit available to them, and depend too heavily upon local banks, taking advantage of the prestige which their financial responsibility naturally gives them with the local banker, who feels both a sense of obligation and of pride in serving the full credit requirements of such concerns, without due regard for the unwarranted proportion of his bank's resources which such lines of credit absorb.

In such circumstances there is a natural tendency for the bank to either entirely disregard the legal loan limit or to carry the loan in such form as to comply with the letter of the law, but with little or no regard for its intent and spirit. Such departures from the rules of law and sound banking are usually defended or excused upon the ground that the bank owes its community the duty of fostering its local enterprises.

In this manner most of the large, unliquid or hazardous lines of credit which lead banks into ultimate trouble and disaster, find their way into their assets. The lending bank is ultimately drawn into a position where the bulk of its lending power is monopolized by a few borrowers, which cripples its ability to function for the benefit of the community at large. According to our conception of a bank's duty to its community, its primary obligation is to keep its assets sufficiently liquid and well distributed to insure its ability at all times to extend credit to each deserving customer with due regard for the rights and claims of all other customers. It is a happy circumstance that when a bank functions with due regard for its own welfare it thereby conserves and increases its ability to promote the welfare of its community.

For these reasons it is our policy, in connection with rediscount offerings submitted to us, to scrutinize closely all notes, bill-of-lading drafts, and bills of exchange which bear any evidence of representing lines of credit exceeding the legal limit, or large lines—not technically excessive,—which appear to be "split" or otherwise modified to evade the loan limit. The provisions of the National Bank Act and of the Federal Reserve Act with respect to the limitation of loans have been so liberalized by amendments that there appears to be no good reason why our member banks should not be able to conform both to the letter and spirit of the law and at the same time furnish adequate credit facilities for the indispensable needs of their communities.

Yours very truly,

