



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

March 9, 1951.

TO ALL FINANCING INSTITUTIONS IN THE UNITED STATES:

Section 708 of the Defense Production Act of 1950 authorized the President to encourage financing institutions to enter into voluntary agreements and programs which will further the objectives of that Act. By Executive Order the President delegated to the Board of Governors of the Federal Reserve System his authority with respect to financing under this section of the Act. A program for voluntary credit restraint has been developed by representatives of financing institutions and has been approved by the appropriate Government officials as required under the Act. It is hoped that you will give your full support to this program, a copy of which is enclosed.

The Voluntary Credit Restraint Committee, provided for in the program, is being organized and the subcommittees which are to be designated by the Voluntary Credit Restraint Committee will be appointed as promptly as possible. If you have questions regarding the program or operations under it, it is suggested that you discuss them with the subcommittees.

Sincerely,

A handwritten signature in cursive script that reads "Thomas B. McCabe".

Thomas B. McCabe,
Chairman.

FEDERAL RESERVE BANK
OF DALLAS

Dallas, Texas, March 13, 1951

VOLUNTARY CREDIT RESTRAINT

To All Financing Institutions in the Eleventh Federal Reserve District:

There is quoted below a statement issued by the Board of Governors of the Federal Reserve System for release in the morning newspapers of March 13, 1951:

"The Board of Governors of the Federal Reserve System is transmitting to all financing institutions in the United States copies of a program for voluntary credit restraint which has been worked out by representatives of commercial banking, investment banking and life insurance.

"Section 708 of the Defense Production Act of 1950, and the Executive Order of the President No. 10161, authorized the Board of Governors to encourage financing institutions to enter into voluntary agreements and programs to restrain credit where such restraint will further the objectives of the Act. The program for voluntary credit restraint which was worked out by representatives of financing institutions in consultation with the Board has as its major objective loan screening by all financing institutions in the United States to eliminate loans which are not necessary to financing the defense program and are not essential to the needs of agriculture, industry and commerce.

"A national committee to be known as the Voluntary Credit Restraint Committee will be created, the members of which will be appointed by the Board of Governors of the Federal Reserve System. Initially the Committee will consist of twelve members, four representing the life insurance companies, four representing the investment bankers, and four representing the banks. This membership may be expanded in the future if deemed advisable. This Committee will meet from time to time for the purpose of considering the functioning of the program and advising the Board of Governors with respect thereto. The Committee will also appoint sub-committees throughout the United States to be available for consultation with individual financing institutions and to assist them in determining the application of the program with respect to specific loans.

"Participation in the program is entirely voluntary, but the Board of Governors expressed the hope that all financing institutions would join in the program and cooperate in carrying it out and making it effective. The request to comply with the program which has been transmitted by the Board to all financing institutions has, as required by the Law, been issued after consultation with the Attorney General and the Chairman of the Federal Trade Commission and approved by the Attorney General. Under the Law, actions of financing institutions in accordance with the program and the request are exempt from the prohibitions of the Antitrust Laws and the Federal Trade Commission Act of the United States. Attached are copies of the program and of the request, together with the Board's letter of transmittal to all financial institutions."

The material referred to in the press statement is enclosed.

Yours very truly,

R. R. GILBERT

President

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 nonessential purposes be curtailed in order to release some of the nation's 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 loans 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 as to purpose 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 over-all 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 Regulations U or T.

* * * * *

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 per cent and 30 per cent, 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, 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 over-all efforts to restrain inflation. To be helpful, this Program must rely on the good will of all financing institutions and the over-all 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

* Loans additional to those needed for a borrower's normal business may, of course, be regarded as proper when they are for the purpose of defense production or otherwise conform to the types of loans listed as proper in this Statement of Principles.

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"). Members shall be appointed for such terms as the Board may prescribe. 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. 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 to such extent as may be deemed desirable in view of any distribution previously made;

(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. One of the members of each subcommittee located in any city in which there is a

Federal Reserve Bank or branch thereof will be a Federal Reserve representative designated by the Board of Governors of the Federal Reserve System or by such Federal Reserve Bank or branch; and such member shall attend each meeting of the subcommittee. For the investment bankers, the life insurance companies, and the banks there may in each case be one or more subcommittees organized. All such subcommittees will meet only for the purposes specified in the Program; will maintain records of their actions; and will make reports directly to the Committee regarding the actions taken by them, including statements of the types of cases considered and the nature of the advice given. 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 Associa-

PROGRAM FOR VOLUNTARY CREDIT RESTRAINT

tion of Securities Dealers, and for the life insurance companies, jointly by the Life Insurance Association of America and the American Life Convention. Compilations of data 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 participating in the Program 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 shall be made in accordance

with the requirements of Section 708 of the Defense Production Act of 1950.

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.

REQUEST TO FINANCING INSTITUTIONS BY BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM TO ACT PURSUANT TO A PROGRAM FOR VOLUNTARY CREDIT RESTRAINT UNDER SECTION 708 OF DEFENSE PRODUCTION ACT OF 1950

This "Request" is addressed to all financing institutions in the United States, including without limitation all individuals, firms, partnerships, corporations and other organizations of any kind which are engaged in the business of extending credit, making loans, or purchasing, discounting, selling, distributing, dealing in, or underwriting securities, any and all of such institutions being hereinafter referred to as "financing institutions."

Pursuant to the provisions of section 708 of the Defense Production Act of 1950 (hereinafter called the "Act") and of section 701 of Executive Order No. 10161, the Board of Governors of the Federal Reserve System has consulted with representatives of financing with a view to encouraging the making of voluntary agreements and programs to further the objectives of the Act. As a result of such consultations, such representatives have prepared a "Program for Voluntary Credit Restraint," including as a part thereof a Statement of Principles, the entire document being hereinafter referred to as the "Program." The Program is attached hereto.

The Board of Governors of the Federal Reserve System hereby approves the Program and finds the Program to be in the public interest as contributing to the national defense. Under section 708 of the Act and section 701 of the said Order, acts or omissions to act pursuant to this Request and the Program which occur while said section 708 is in effect and before the withdrawal of this Request or of the finding of the Board in the preceding sentence are not construed to be within

the prohibitions of the antitrust laws or the Federal Trade Commission Act of the United States.

The Board of Governors of the Federal Reserve System has consulted with the Attorney General and with the Chairman of the Federal Trade Commission on and before February 5, 1951, said date being not less than 10 days before the date of this Request, with regard to the provisions of the Program, the finding by the Board above mentioned and this Request; and the Attorney General has given his approval to the making of this Request.

Every financing institution in the United States is hereby requested by the Board of Governors of the Federal Reserve System to act, and to refrain from acting, pursuant to and in accordance with the provisions of the Program. The national committee which is to be set up pursuant to the provisions of the Program, each and every subcommittee set up pursuant to the provisions of the Program, and each and every individual who may become a member of said national committee or of any of said subcommittees are hereby requested by the Board of Governors of the Federal Reserve System to act, and to refrain from acting, pursuant to and in accordance with the provisions of the Program.

By order of the Board of Governors of the Federal Reserve System this 9th day of March, 1951.

S. R. Carpenter,
Secretary.

BULLETIN NUMBER 1 OF VOLUNTARY CREDIT RESTRAINT COMMITTEE

The Voluntary Credit Restraint Committee at its meeting on March 14 and 15 in Washington gave consideration to the functioning of the program as developed by the financing institutions and approved by the appropriate government agencies.

Regional committees are in the process of formation to be available for consultation by lenders who have specific questions on the application of the credit restraint program.

The Committee recognizes that there are many inflationary influences at work. The Committee expects to issue further bulletins from time to time on various phases of the voluntary credit restraint program. This bulletin deals with the matter of inventory financing.

Inventories in the United States, particularly at wholesale and retail establishments, are at peak levels even after allowance is made for the sharp increase in prices at which inventories are carried. An important part of this abnormal increase in inventories has been financed by borrowed money.

Excess inventory accumulation has already contributed directly to the rise of wholesale and retail prices beyond any level justified by the supply situation. It obviously has created undue competition in scarce materials.

In the light of the above, the Voluntary Credit Restraint Committee expressed the hope that all financing institutions would, in carrying out the terms of the program

- (1) Refrain from financing inventory increases above normal levels relative to sales, or reasonable requirements by other conservative yardsticks.
- (2) Encourage borrowers who already have excess inventories to bring these commitments and inventory positions in line as promptly as is reasonably practical, thereby reducing the amount of credit being used in this manner.

THE COMMITTEE ON VOLUNTARY CREDIT RESTRAINT

*Committee action of
March 15, 1951.*