at Circular No. 7122

CHAIRMAN OF THE BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

April 6, 1973

To the Chief Executive Officer of Each State
Member Bank with Deposits Exceeding $100 Million:

Dear Sir:

I am writing to you about a matter of concern to all members of the Board--the heavy volume of bank loan commitments to commercial and industrial companies and financial institutions. Banks supervised by other Federal banking agencies are receiving similar letters, so that the attention of all banks likely to have substantial loan commitments will be drawn to the need for appropriate loan commitment policies.

By loan commitments we refer to all of your bank's official promises to lend which have been expressly conveyed to your customers, typically by means of either a formally executed commitment agreement or a letter signed by one of your officers confirming the availability of a line of credit of specified size.

There is no question as to the legitimacy of--and the need for--bank loan commitments. They serve the purposes of sound business planning, both for banks and their customers. It is the intention of the Federal bank supervisors that this practice continue, but that it be based on careful judgment, in the interests of a sound banking system and healthy economic expansion. The apparent large volume of bank commitments currently outstanding and sharply increased takedowns thereunder are indicative of the need for special attention to this subject at this time.

Each bank should maintain a record of the aggregate volume of its commitments to lend. Furthermore, it should periodically make a careful judgment as to the potential volume of takedowns of these commitments under reasonably foreseeable circumstances, including periods of strong as well as weak loan demand, and the appropriateness of the credit risks involved to its overall capital position. Finally, it should give adequate consideration as to how it would obtain the funds to meet such takedowns in sound and timely fashion, giving due allowance to the possibilities for changing conditions in the local and national economy and in the central money markets.

Federal bank examiners will henceforth ask the management of each bank they examine to demonstrate that it is giving adequate attention to the above principles. Steps are also being taken by the bank supervisory authorities to obtain current information periodically as to ongoing developments with respect to bank loan commitments.

We confidently expect that banks will cooperate in this program to help insure that bank loan commitments play a sound and useful role in the financing of business activity.

Sincerely yours,

Arthur F. Burns