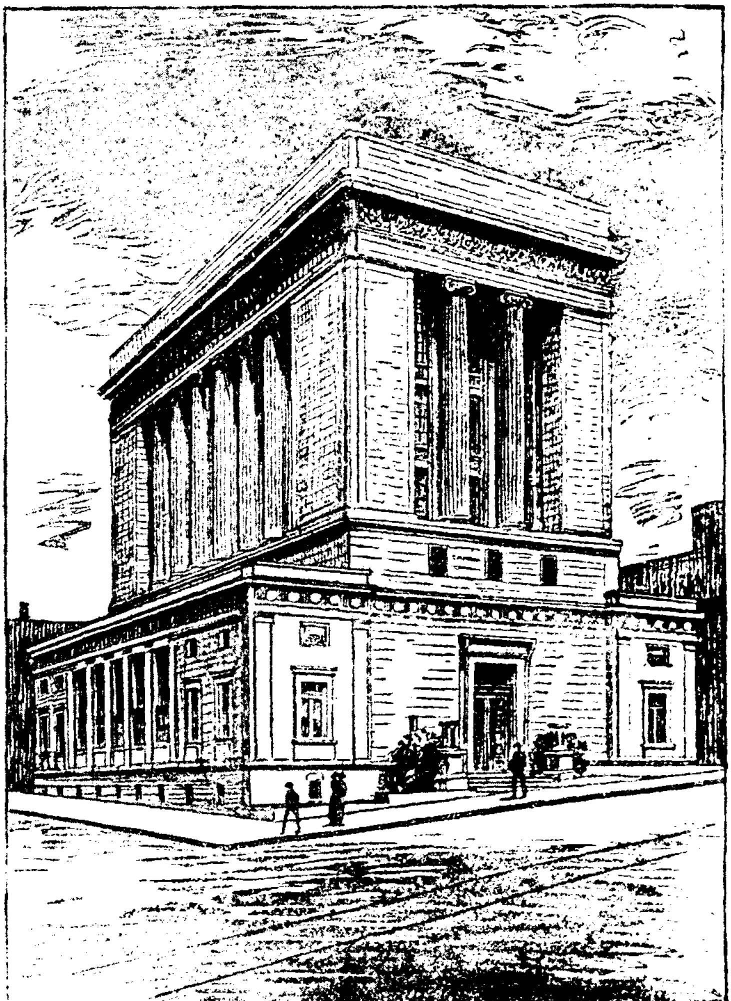

Federal Reserve Bank of Richmond

Questions and Answers on the Federal Reserve System

Federal Reserve Bank of Richmond
Richmond, Virginia

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Contents

Foreword

AMONG the most important duties of the officers of a Federal reserve bank is that of acquainting member banks, and banks that may wish to become members, with the various functions of a Federal reserve bank, with the possible benefits of membership in the Federal Reserve System if it be properly taken advantage of, and with the best ways in which to deal with a Federal reserve bank in order to secure the greatest amount of good from the association.

This duty is discharged in various ways: by circulars issued from time to time, by correspondence directly with the officers of member and non-member banks, and by personal interviews at their offices and at the offices of the Federal reserve bank. In the course of such correspondence and interviews, many questions are asked and answered.

In this little book we have endeavored to arrange in logical order many of the questions we have answered from time to time. We have added to these a number of other questions that naturally suggest themselves. By putting a table of contents at the beginning and a comprehensive index at the end, and by printing and binding it in the present form, we have sought to make the book of further value as a ready reference, available at all times.

We are greatly indebted to the Federal Reserve Banks of San Francisco, Minneapolis, and New York for permission granted by them to make use of similar books which have been prepared by them, on the same general plan, and from which we have drawn frequently and freely in the preparation of this book.

FEDERAL RESERVE BANK OF RICHMOND.

I. Introduction

1. What Is the Federal Reserve System?

It is a system of banking, established and operated under the provisions of an Act passed by Congress and approved December 23, 1913, known as the Federal Reserve Act, the long title of which is,

> "AN ACT *to provide for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.*"

2. Why Was the Federal Reserve System Established?

To remedy the defects of the banking system of the United States.

For twenty years or more before the passage of the Federal Reserve Act, reforms in the banking laws of the United States had been continually discussed. The National Banking System, which was established in 1864, was admittedly imperfect in many respects. Panics occurred with comparative frequency and regularity; and, whenever a panic occurred, the defects of the National Banking System, aggravated by the imperfections of the various state banking systems in existence, became increasingly apparent. Students of finance, economists, and the more thoughtful bankers generally were convinced that many, if not all, panics were avoidable, especially those arising from scarcity of currency, and that the United States had reached a point where agriculture, commerce, and industry demanded banking facilities of the highest efficiency.

On May 30, 1908 (largely because of the panic of 1907), Congress established a National Monetary Commission consisting of sixteen members to inquire into, and report to Congress, what changes were necessary or desirable in the monetary system of the United States. This Commission rendered its report, comprised in fifteen or twenty volumes, January 9, 1912. Organized efforts to revise the banking laws followed immediately, and these efforts culminated in the adoption of the Federal Reserve Act, which embodies the chief recommendations of the National Monetary Commission.

3. What Were the Chief Objections to the Old National Banking System?

The chief objections to the old National Banking System are concisely stated in the report of the National Monetary Commission, which listed seventeen defects, of which the most important were as follows:

(1) THERE *was no provision for the mobilization and use of the scattered reserves of the banks of the country.*

(2) ANTIQUATED *Federal and State law restricted the use of bank reserves and curtailed the lending power of banks during periods of stress when reserves should be freely used and credit liberally extended to all deserving customers.*

(3) BANKS *lacked the ability to replenish their reserves or increase their lending power to meet unusual demands.*

(4) THE COUNTRY *was hampered by an inelastic*

currency made up chiefly of bank note issues the volume of which was usually dependent upon the amount of United States bonds held by the issuing banks and the price of bonds.

(5) BANKS *were without means of co-operation and deprived of the possibility of joint action in times of stress.*

(6) LACK *of an established market for agricultural, industrial, and commercial paper led to an unhealthy congestion of loanable funds in great centers, tending to encourage speculation and injurious disturbances to reserves. The United States lacked a broad discount market.*

(7) THERE *was a marked lack of equality in credit facilities between different sections of the country.*

4. Has the Establishment and Operation of the Federal Reserve System Remedied These Conditions?

The establishment and operation of the Federal reserve banks, under the Federal Reserve Act and the various amendments thereto, have completely remedied many of the defects incident to the inefficiency and inadequacy of the National Banking System as it existed before the establishment of the Federal reserve banks. Other conditions have been greatly modified, and it is confidently believed that, as the Federal Reserve System is expanded and developed, many if not all of these remaining defects will be corrected. The reserves of member banks have been concentrated in the Federal reserve banks. Additional funds have been acquired through the subscriptions of member banks to the capital stock of the Federal reserve banks and through deposits from the United States Government. A thoroughly elastic currency has been provided, and, at the same time, the credit power of bank reserves concentrated in the Federal reserve banks has been enormously increased by the issue of Federal reserve notes. Member banks have been enabled to take care of practically all legitimate demands from their agricultural, industrial, and commercial customers by rediscounting with the Federal reserve banks the notes, drafts, and bills of exchange arising from current transactions. Virtual equality in credit facilities in all parts of the country has been created and discount rates made more uniform than they have ever been in the history of the country.

Moreover, the Federal Reserve System has carried the country through the strain of war financing with astonishing success. It is difficult, if not impossible, to see how the banks could have carried the burden of war finance and accommodated their customers but for the existence and efficient operation of the System. Knowing that the Federal Reserve System was behind the banks of the country, the depositing public (because of its entire confidence in the System) has been content to leave on deposit in banks in every part of the country funds which, under other conditions, according to previous experience, would undoubtedly have been withdrawn for the purpose of hoarding. In this respect, every bank in the United States has benefited, whether it was a member of the System or not; and the cumulative effect of this widespread confidence has been, perhaps, the largest factor in making our huge war financing operations possible.

5. Did the Establishment of the Federal Reserve System Involve the Incorporation in the American Banking System of New and Untried Banking Principles?

It did not. Before the Federal Reserve Act was framed, there was a thorough study of banking conditions and banking methods in this country, and the successful banking systems of many other countries also were exhaustively studied and analyzed. The Federal Reserve Act is the adaptation to American conditions of those banking principles in the banking systems of England, France, Germany, and other industrial and commercial countries which long experience has proved to be the best.

6. Is There Any Provision by Which the Operations of Federal Reserve Banks May Be Changed to Meet Changing Conditions?

The provisions of the Act looking to this end are of two kinds: first, the requirements of the law are stated as broadly as possible, and the duty of making definite application through regulations issued from time to time is imposed upon the Federal Reserve Board; second, it is the duty of the Board to keep in touch with conditions, to keep itself constantly informed with reference to the effects of the operation of the various provisions of the Act, and to suggest to Congress from time to time such amendments to the Act as, in the opinion of the Board, may be necessary or advisable.

As experience has been gained in the operation of the Federal reserve banks, regulations have been modified from time to time and amendments to the Act have been passed by Congress. The advantage of having the operations of the System continually observed and studied by a body of experts whose duty it is to keep the System fully up to current requirements at all times is probably greater than the majority of bankers and business men have realized.

II. Organization

7. Of What Elements Does the Federal Reserve System Consist?

The Federal Reserve System consists of:

(1) THE FEDERAL *Reserve Board.*

(2) THE FEDERAL *Advisory Council.*

(3) THE FEDERAL *Reserve Banks.*

FEDERAL RESERVE BOARD.

8. What Is the Federal Reserve Board and How Is It Constituted?

The Federal Reserve Board is the governing body of the Federal Reserve System and consists of seven members, five of whom are appointed by the President of the United States, by and with the advice and consent of the Senate. The other two members of the Board are the Secretary of the Treasury and the Comptroller of the Currency, who are members ex-officio. Of the five appointed members, two must be experienced in banking or finance, and not more than one can be selected from any one Federal reserve district. In making the selections, the President is required to have due regard to a fair representation of the different commercial, industrial, and geographical divisions of the country. Each of the five appointive members holds office for a period of ten years, but the terms of the first appointees were designated as two, four, six, eight, and ten years, respectively, so that a new appointment or a reappointment occurs once in every two years. The President designates one of the five as Governor, and another as Vice-Governor of the Federal Reserve Board.

9. What Are the Powers and Duties of the Federal Reserve Board?

The Federal Reserve Board has general supervision over the twelve Federal reserve banks. Its function is to determine uniform policies for the twelve Federal reserve banks and to co-ordinate their activities. Its powers are set forth in detail in Sections 10 and 11 of the Federal Reserve Act.

FEDERAL ADVISORY COUNCIL.

10. What Is the Federal Advisory Council?

The Federal Advisory Council is composed of twelve members, one from each Federal reserve district, chosen annually by the board of directors of the Federal reserve bank of the district. The purpose of the Council is to give the Federal Reserve Board the benefit of the counsel and advice of men outside the active operations of the System.

The regular meetings of the Council are held at Washington, District of Columbia, at least four times each year, and oftener if called by the Federal Reserve Board. It may meet, however, on its own initiative, and may hold special meetings at Washington or elsewhere, as it may deem necessary.

The Council has power (1) to confer directly with the Federal Reserve Board on general business conditions; (2) to make oral or written representations concerning matters within the jurisdiction of the Board; (3) to call for information and to make recommendations in regard to discount rates, rediscount business, note issues, reserve conditions in the various districts, the purchase and sale of gold or securities by the reserve banks, open market operations by the reserve banks, and the general affairs of the Federal Reserve System.

FEDERAL RESERVE BANKS.

11. Are the Federal Reserve Banks Government Institutions?

Since all the stock in the Federal reserve banks is owned by member banks, and since the majority of the board of directors of each Federal reserve bank are elected by member banks, Federal reserve banks are not under the control of the Government. They are required, however, to perform certain services for the Government, generally known as Fiscal Agency Operations (see Question No. 25). A minority of the board of each Federal reserve bank are appointed by the Federal Reserve Board (see Question No. 14), and a certain portion of the excess profits of each Federal reserve bank is required to be paid to the Government as a franchise tax (see Question No. 30).

12. How Many Federal Reserve Banks Are There?

Twelve. The continental United States is divided into twelve Federal reserve districts, each district containing a Federal reserve city (that is, a city in which a Federal reserve bank is located); the districts are apportioned "with due regard to the convenience and customary course of business" and are not necessarily coterminous with state lines. The districts thus created may be readjusted from time to time by the Federal Reserve Board, but not more than twelve Federal reserve districts in all may be created. There is a Federal reserve bank in each one of these districts, located, of course, in the designated Federal reserve city of the district. Each Federal reserve bank is an autonomous or self-governing institution, under a board of nine directors, of whom six are elected by the member banks of the district and three are appointed by the Federal Reserve Board.

13. In What District Is the Federal Reserve Bank of Richmond?

The Federal Reserve Bank of Richmond is in the Fifth Federal Reserve District, which embraces the District of Columbia, the states of Maryland, Virginia, North Carolina, South Carolina, and West Virginia (except six counties in the extreme northwestern part of the state). The banking power of the Fifth Federal Reserve District is shown by the following table:

(These figures are as of February 28, 1920.)

	No.	000 omitted			
		Capital	Surplus	Deposits	Resources
National Bank Members	544	$77,662	$54,982	$928,625	$1,242,803
State Bank Members...	48	12,745	8,507	105,149	163,298
Eligible Non-Members..	665	67,507	38,784	555,945	720,776
Ineligible Non-Members.	798	17,767	9,290	253,730	301,774
TOTALS............	2,055	$175,681	$111,563	$1,843,449	$2,428,651

14. How Is a Federal Reserve Bank Managed?

Each Federal reserve bank is managed by a board of nine directors, six being elected for terms of three years each by the member banks and three appointed for similar terms by the Federal Reserve Board. The first elected and appointed directors, however, were allotted terms of one, two, and three years, respectively, so that two directors are elected each year by the member banks and one is appointed each year by the Federal Reserve Board. The nine directors are designated as Class A, Class B, and Class C directors, respectively. Directors of Class A (three in number) are chosen by, and intended to be representatives of, the stock-holding banks. They may be officers and stockholders in member banks. Class B directors (three in number) are also elected by member banks, but must be men who are actively engaged in commerce, agriculture, or some other industrial pursuit. No Class B director can be an officer, director, or employee of a bank, though Class B directors may be stockholders of banks. Directors of Class C (three in number) are appointed by the Federal Reserve Board. No director of Class C can be an officer, director, employee, or stockholder of any bank. One of the Class C directors is designated by the Federal Reserve Board as Federal Reserve Agent and Chairman of the Board of Directors of the Federal reserve bank to which he is appointed. Another Class C director is designated by the Federal Reserve Board as Deputy Chairman.

15. How Are Class A and Class B Directors Elected?

The member banks in each Federal reserve district are divided by the Federal Reserve Board into three general groups or divisions, which are designated as Group 1, Group 2, and Group 3, respectively. Each group consists, as nearly as possible, of banks of similar capitalization. In the Fifth Federal Reserve District, Group 1 is composed of member banks each one of which has a combined capital and surplus in excess of $599,000. Group 2 consists of member banks each one of which has a combined capital and surplus of not less than $150,000 and not more than $599,000. The remaining member banks in the District, the combined capital and surplus of each one of which is less than $150,000, are classified in Group 3. Each group nominates and elects one Class A and one Class B director in the manner prescribed by Section 4 of the Federal Reserve Act. No officer or director of a member bank is eligible to serve as a Class A director unless nominated and elected by banks which are members of the same group as the member bank of which he is an officer or director; and, in case he is an officer or director of more than one member bank, he can be nominated and elected only by the group which embraces the largest bank of which he is an officer or director.

16. What Are the Qualifications and Duties of the Chairman of the Board and Federal Reserve Agent?

He must be "a person of tested banking experience." In addition to his duties as Chairman of the Board, he is required to maintain a local office of the Federal Reserve Board on the premises of the bank. He is the official representative of the Federal Reserve Board. One of his important duties is to issue Federal reserve notes to the Federal reserve bank and to hold the securities against which the notes are issued.

17. How Are the Other Officers of the Federal Reserve Bank Chosen?

By the Board of Directors, which has power to create all offices other than those of Director, Chairman of the Board, Federal Reserve Agent, Assistant Federal Reserve Agent, and Deputy Chairman of the Board; to appoint the officers and employees, and to prescribe their duties. The head of the executive department of the bank bears the title of Governor, and under him are usually one or more Deputy Governors, a Cashier, and one or more Assistant Cashiers.

18. How Large Is the Staff of the Federal Reserve Bank of Richmond?

On January 1, 1920, the Federal Reserve Bank of Richmond had 399 officers and employees, including 101 at the Baltimore Branch and 23 at the War Loan Organization; on July 1, 1920, the total was 555, including 142 at the Baltimore Branch and 23 at the War Loan Organization.

19. How Are the Salaries of Officers and Employees of a Federal Reserve Bank Fixed?

The salary of the Chairman of the Board and Federal Reserve Agent is fixed by the Federal Reserve Board. The other directors are paid attendance fees, which are fixed by resolution of the board of each Federal reserve bank as approved by the Federal Reserve Board. The salaries of all other officers of a Federal reserve bank are fixed by the board of directors of the bank, and the salaries of other employees are fixed by the same board or by the executive committee with the approval of the board. All salaries, however, are subject to the approval of the Federal Reserve Board, and each bank is required to make full reports to the Federal Reserve Board with reference to salary adjustments.

20. Are Branch Offices of a Federal Reserve Bank Permitted?

Yes. The Federal Reserve Board may permit or require any Federal reserve bank to establish branch banks.

21. How Are the Branches Operated?

They are operated under the supervision of a board of directors, to consist of not more than seven nor less than three directors, of whom a majority of one shall be appointed by the Federal reserve bank of the district, and the remaining directors by the Federal Reserve Board. The directors of branch banks are appointed for a term of one year and hold office during the pleasure of the Federal Reserve Board. The active head of the branch is called the Manager and is appointed by the directors of the Federal reserve bank of the district, from among the directors appointed by it. The activities of the branch are determined by by-laws framed by the board of the Federal reserve bank as approved by the Federal Reserve Board.

22. Do the Branch Banks Serve Particular Parts of the District?

Yes. Each branch is usually assigned a certain territory embracing the banks which normally transact business with the city in which the branch is located.

23. What Are the Chief Governing Factors Which Determine the Establishment of a Branch?

First, whether that part of a Federal reserve district for which a branch is proposed can be more efficiently served by a branch than by the Federal reserve bank of the district; in this question, railroad facilities and mail schedules play an important part. Second, whether the improved facilities afforded by the branch to the members located in the territory to be assigned to it will warrant the increased expenditure involved by the creation of the branch, and whether the establishment of the branch will be a distinct economic gain to the banking and commercial business of the district.

24. How Many Branches Has the Federal Reserve Bank of Richmond?

The Federal Reserve Bank of Richmond has one branch, located at Baltimore, Maryland. The territory assigned to the Baltimore Branch is the entire State of Maryland and that part of West Virginia, approximately one-half, the railroad facilities of which make it more convenient for the banks located therein to deal with the Branch.

25. Do the Federal Reserve Banks Perform Any Services for the Federal Government?

Yes. They are required by the Federal Reserve Act to serve as Fiscal Agents of the Federal Government. During all the Liberty Loan campaigns, they acted in this capacity, received subscriptions for bonds, notes, and certificates of indebtedness, made collections on these subscriptions, and delivered securities to subscribers upon completion of payment. In connection with these subscriptions, numerous and large transactions in the nature of redeposits with qualified depositors were conducted; collateral for such deposits, as required by law, was received and held by the Federal reserve banks. In each district an active War Loan Organization, of which the Governor of the Federal reserve bank was the responsible head, conducted the practical operations of the campaigns. Thrift stamps, war savings stamps, and Treasury savings certificates were sold and distributed, and are still being so handled.

The Federal reserve banks have, in their capacity as Fiscal Agents, performed for the Government services of the highest value. The extent of the work of the Federal Reserve Bank of Richmond as Fiscal Agent is indicated by the fact that the Liberty Loan Department, including the War Loan Organization, had at one time approximately 150 employees. Liberty bonds and Victory notes were sold in the Fifth District to an amount exceeding one billion dollars. In addition to this, a large volume of war savings stamps, Treasury savings certificates, and certificates of indebtedness of various issues was successfully placed.

In the near future, the various sub-treasuries of the United States, now in existence, will be discontinued, and Federal reserve banks and their branches will be called upon to exercise many of the sub-treasury functions for the Government. They are already rendering an important service to the Government and to the public in connection with the receipt of deposits from collectors of revenue, and the payment of Government checks and the coupons from bonds of the various loans.

III. Membership

ELIGIBILITY.

26. What Banks May Be Members of the Federal Reserve System?

All national banks are required to be members, and eligible state banks and trust companies may become members with the approval of the Federal Reserve Board.

See Chapter VII., "State Bank and Trust Company Membership" (pages 60-82 of this book), in which the subject of State Bank Membership is fully covered.

STOCK SUBSCRIPTIONS.

27. For How Much Stock Must a Member Bank Subscribe?

For an amount equal to six per cent. of its paid-up capital and surplus. If a member bank increases or decreases its capital or surplus, it must increase or decrease accordingly its stock in the Federal reserve bank. Stock adjustments are usually made shortly after the first days of January and July of each year, when it is customary for banks to carry part of their earnings to their surplus. Increases or decreases of capital or surplus at other times, if considerable in amount, should be followed by a corresponding adjustment of stock holdings in the Federal reserve bank.

28. When Is the Subscription to the Capital Stock to Be Paid?

One-half of the subscription must be paid at the time the applicant bank becomes a member, or when the capital stock or surplus of the member bank is increased, and the other half paid upon call of the Federal Reserve Board. Up to this time, the Federal Reserve Board has not called for any part of the second half of the stock subscription of member banks. Each member bank, therefore, holds stock of a paid-in value equal to three per cent. of its paid-in capital stock and surplus.

DIVIDENDS AND DIVISION OF EARNINGS.

29. Are Dividends Paid on the Stock of Federal Reserve Banks?

Yes. The Federal Reserve Act provides for the payment of an annual dividend of six per cent. on the paid-in value of the stock. Moreover, this dividend is cumulative. That is to say, if the earnings of a Federal reserve bank do not justify the dividend in any particular year, and the accumulated surplus is not sufficient to provide for the dividend, it is paid only in part, but the remainder is payable in the following year, in addition to the current dividend for that year, provided the profits are sufficient to make the payment. All twelve of the Federal reserve banks have paid the full six per cent. dividends from the date of organization to the last dividend period, and each Federal reserve bank has a surplus fund sufficiently large to insure the payment of the six per cent. dividends regularly in the future.

30. What Becomes of the Earnings of a Federal Reserve Bank Above Dividend Requirements?

Under the Federal Reserve Act as originally passed, Federal reserve banks were required to pay all surplus earnings to the Government as a franchise tax, except that they were allowed to retain one-half of such surplus earnings until a surplus fund of forty per cent. of paid-in capital had been accumulated. Later, however, the law was amended, and now Federal reserve banks are allowed to retain all surplus earnings until a surplus fund equal to one hundred per cent. of the subscribed capital is accumulated (this is two hundred per cent. of the present paid-in capital); and, after the establishment of such a surplus, ten per cent. of the surplus earnings (after the payment of the current dividend) is to be retained by the bank and the remainder paid to the Government as a franchise tax.

31. Why Was the Law Changed and What Are Some of the Effects of the Change?

Owing to the participation of the Federal reserve banks in Government financing during the war, their earnings were enormously greater than any one had anticipated, and it is difficult, if not impossible, to believe that they can continue in anything like the same degree. It was thought wise, therefore, that these extraordinary profits should be retained, at least in part, for the benefit of member banks through the increased power of service on the part of the Federal reserve banks. The accumulation by each Federal reserve bank of a surplus equal to its total subscribed capital (twice its present paid-in capital) will insure not only the regular payment of dividends in future years, whether the profits of each year warrant the payment of the current dividend or not, but also the continuance and enlargement of many services which the Federal reserve banks are performing for their members without charge.

32. What Is the Amount of the Capital Stock and Surplus of the Federal Reserve Bank of Richmond?

On June 30, 1920, the paid-in capital was $4,824,650; the surplus was $8,067,365.

IV. Functions of Federal Reserve Banks

33. What Are the Principal Functions of Federal Reserve Banks?

The principal functions of Federal reserve banks are:

(1) To EFFECT *the concentration or mobilization of the reserves of their members.*

(2) To PROVIDE *an elastic currency by the issue of Federal reserve notes.*

(3) To AFFORD *means of rediscounting industrial, commercial, and agricultural paper.*

MOBILIZATION OF RESERVES.

34. How Do Federal Reserve Banks Effect the Mobilization of Reserves?

Each member bank is required to carry its reserve with the Federal reserve bank of its district. Each Federal reserve bank is, therefore, a reserve center for its district, and the reserves of all twelve Federal reserve banks are effectively centralized through the provision of the Act that the Federal Reserve Board may permit or require Federal reserve banks to rediscount for each other. If, therefore, the demand for accommodation is heavy in one section of the country and light in another, the district in which the demand is light may be called upon to aid the district in which the demand is heavy. Rediscount transactions between Federal reserve banks are conducted by wire through the leased wire system connecting all Federal reserve banks and branches. By this method, relief is obtainable as soon as it is needed.

35. Has This Privilege of Rediscounting Between Federal Reserve Banks Been Availed of by Any of Them?

Yes. All the Federal reserve banks have rediscounted with or for each other during the past two years. At one time the Federal Reserve Bank of Richmond had rediscounts with other Federal reserve banks amounting to fifty-five millions of dollars, a sum greater than all the available reserve deposits of its member banks at the time. At other times the Federal Reserve Bank of Richmond has rediscounted for other Federal reserve banks. During the year 1919 rediscount facilities in greater or less volume were in constant use.

ELASTIC CURRENCY.

36. How Do Federal Reserve Banks Furnish an Elastic Currency?

By the provisions of the Federal Reserve Act, a Federal reserve bank is allowed to issue Federal reserve notes. These notes are a direct obligation of the United States. The holders, however, have a first lien upon the assets of the Federal reserve bank by which they are issued. All the notes issued by a Federal reserve bank bear the number and letter of the issuing bank. Federal reserve notes have been issued in the following denominations: \$5, \$10, \$20, \$50, \$100, \$500, \$1,000, \$5,000, and \$10,000.

The process of issuing Federal reserve notes may be briefly described as follows:

Unissued notes in sufficient volume and of the various denominations are lodged with the Federal Reserve Agent and kept by him in special compartments in the vault of the Federal reserve bank in joint custody with an officer of the bank. Upon requisition of the bank, notes are turned over to the bank by the Federal Reserve Agent, who must, however, take collateral for the notes, which collateral he must continue to hold as long as the notes remain outstanding. The collateral may consist of gold, or of industrial, commercial, or agricultural paper, eligible for rediscount, or partly of one and partly of the other. The Agent must hold collateral to the full amount of outstanding Federal reserve notes. If he holds forty per cent. gold and sixty per cent. eligible paper, the bank is not required to hold a gold reserve against the notes. If, however, he holds less than forty per cent. of gold, the bank is required to hold a sufficient amount of gold to make up forty per cent., notwithstanding the fact that it may have more than sixty per cent. of paper lodged with the Agent as collateral. The Agent is required to deposit with the Treasurer of the United States as a redemption fund five per cent. of the gold held by him as collateral for Federal reserve notes, and the bank is required to deposit an additional amount sufficient to make the redemption fund in the hands of the Treasurer of the United States equal to five per cent. of the total amount of outstanding Federal reserve notes.

Federal reserve notes are redeemable in gold at the

Treasury Department at Washington and in gold or lawful money at any Federal reserve bank. Every Federal reserve bank is required to redeem the notes issued by another Federal reserve bank if presented to it for redemption, but no Federal reserve bank is allowed to pay out the notes issued by another Federal reserve bank. When the paper held by the Federal Reserve Agent as collateral for outstanding Federal reserve notes matures, it is surrendered to the Federal reserve bank only in exchange for other eligible paper, Federal reserve notes, or gold. It is manifest, therefore, that when the paper upon the discount of which Federal reserve notes were issued matures and is paid, gold must be placed in the hands of the Federal Reserve Agent to meet any outstanding Federal reserve notes originally issued against the paper. As Federal reserve notes can be presented for redemption to the Treasury Department or to any of the Federal reserve banks (and as a matter of fact to any branch of a Federal reserve bank), it is clearly apparent that, regardless of the conditions under which they were originally issued, no greater volume of Federal reserve notes can remain in circulation at any one time than the public has need for and is willing to hold. On the other hand, at each Federal reserve bank the Federal Reserve Agent has at all times an ample supply of unissued Federal reserve notes in various denominations which can be instantly procured by a Federal reserve bank in exchange for gold or eligible paper and put into circulation in response to a demand for currency. We have, therefore, a perfectly elastic currency, which will automatically expand and contract as conditions require.

37. What Is the Limit upon the Note-Issuing Power of a Federal Reserve Bank?

The law requires that a Federal reserve bank must maintain reserves in gold of not less than forty per cent. against its Federal reserve notes in circulation. The total volume of gold held by a Federal reserve bank is, therefore, a very important element of the question. The Federal Reserve Board is authorized to limit the amount of Federal reserve notes which any Federal reserve bank may issue and have outstanding at any one time; and it is also authorized, under certain conditions laid down in the Act, to modify the reserve requirements with respect to Federal reserve notes.

38. What Amount of Federal Reserve Notes of the Federal Reserve Bank of Richmond Are Now Outstanding?

On December 31, 1919, the Federal Reserve Bank of Richmond had in actual circulation Federal reserve notes amounting to $145,765,320; on June 30, 1920, the actual circulation was $124,487,275.

39. What Are Federal Reserve Bank Notes and Why Are They Issued?

When the Federal Reserve Act was passed, that provision of the National Bank Act which required a national bank to invest a part of its paid-up capital in United States bonds against which national bank notes could be issued was repealed, so that while national banks are still allowed to issue notes, it is no longer necessary for them to do so. At the same time, provision was made in the Act for the gradual retirement of national bank circulation and the purchase by Federal reserve banks of the two per cent. United States bonds bearing the circulation privilege. Several such purchases were made by direction of the Federal Reserve Board, but purchases were suspended when the Government began its issues of Liberty bonds.

Federal reserve banks were authorized by the Act to exchange the two per cent. bonds so purchased for three per cent. thirty-year bonds and three per cent. one-year renewable notes, neither of which, however, bore the circulation privilege, but they had the right to retain the two per cent. bonds purchased from national banks and to issue against such bonds Federal reserve bank notes upon the same terms and under the same conditions that national banks are allowed to issue national bank notes. The lowest denomination in which such Federal reserve bank notes could be issued was originally $5, and only a few of the Federal reserve banks exercised the privilege of issuing such notes. But by a later amendment to the Federal Reserve Act, Federal reserve banks were authorized to exchange the one-year renewable three per cent. notes for special one-year two per cent. certificates of indebtedness; to purchase such certificates of indebtedness for cash, and to issue against such certificates Federal reserve bank notes in denominations of $1 and $2. The total amount of such issues, however, was limited to the amount of silver certificates withdrawn from circulation. All the Federal reserve banks have issued $1 and $2 Federal reserve bank notes in accordance with the provisions of the Act, and have thereby added greatly to the facilities of commerce and industry by the circulation of these notes, large numbers of which are needed at certain seasons, particularly during crop-moving periods.

40. To What Extent Have One and Two Dollar Bank Notes Been Issued by the Federal Reserve Bank of Richmond?

The total amount of such notes outstanding on December 31, 1919, was $12,057,950; the total amount on June 30, 1920, was $9,614,741.

REDISCOUNTING.

41. What Determines the Lending Power of a Federal Reserve Bank?

The lending power of a Federal reserve bank is determined by two elements: first, by the amount of its paid-in capital, earned surplus, reserve deposits of member banks, and Government deposits; second, by its power to issue and keep outstanding Federal reserve notes. As will be seen by the following explanation, this second factor greatly supplements the first.

A Federal reserve bank is, of course, not required to hold any reserve against its paid-in capital or earned surplus. It is, however, required to maintain a reserve in gold or lawful money of thirty-five per cent. against the reserve deposits of its member banks and against Government deposits. Therefore, a Federal reserve bank can lend back to its member banks the total amount of its paid-in capital and earned surplus plus sixty-five per cent. of its member banks' reserve and other deposits. This, in any case, would amount to a sum sufficient to accommodate a considerable number of banks, and is a great improvement on the old National Banking System, because the pooling of reserve deposits in a Federal reserve bank makes it possible to take advantage of the fact that the season for expansion in one part of the district frequently coincides with the season for contraction in another part. The power of one Federal reserve bank to rediscount with or for another Federal reserve bank enables the System as a whole to take advantage of the varying time of seasons in different parts of the country. The lending power of a Federal reserve bank, however, does not end here.

It is further increased by the power which is given to Federal reserve banks by the Act to issue Federal reserve notes. Against Federal reserve notes issued and outstanding, the Federal reserve bank is required to maintain a gold reserve of forty per cent., and for the remaining sixty per cent. of the collateral required to be lodged with the Federal Reserve Agent of its district, it may use eligible paper discounted or rediscounted by it for its member banks.

It will be seen, therefore, that if the loans of a Federal reserve bank to its member banks are paid by the Federal reserve bank in gold or lawful money, the limit of its lending power would be reached after it had discounted an amount of paper equal to its paid-in capital, earned surplus, and sixty-five per cent. of its deposits. If, however, it can pay for the loans to member banks in Federal reserve notes, its lending power is two and a half times the amount which it could lend, if payment had to be made in gold or lawful money.

Because of the changes which have been made in the reserve requirements of national banks, which changes were made possible by the establishment of the Federal Reserve System, together with the confidence of the public in the Federal Reserve System, an enormous amount of gold has been accumulated in the Federal reserve banks, and the banks of the country generally and the public at large are entirely willing to receive and hold Federal reserve notes for daily commercial needs.

Because the total amount of Federal reserve notes already issued and outstanding is larger than the total amount of loans to member banks, the Federal reserve banks have a lending power equal to two and a half times the free gold held by them (the amount of their capital, surplus, and sixty-five per cent. of their deposits), so that it is not necessary for the member bank discounting paper with the Federal reserve bank to take and use actual Federal reserve notes, for the reason that there is already a sufficient volume of Federal reserve notes in circulation to include the amount of the transaction.

As a practical demonstration of the truth of the above statement, the Federal Reserve Bank of Richmond held on January 1, 1920, reserve deposits of its member banks amounting to $62,712,000. It was able to lend to its member banks $121,407,000, and to maintain its own reserve at a point substantially higher than the minimum fixed by law. The power to do these things was due to the fact that it had Federal reserve notes issued and outstanding at the time (needed and used in circulation for daily business needs) amounting to $145,755,000.

It will be seen from this explanation that, by pooling their reserves in a Federal reserve bank, member banks have obtained not only the enormous advantage derived from the use of combined reserves at different seasons in different parts of the country, but this power is actually multiplied by the note-issuing power of the institution in which the reserves are pooled.

42. Has Every Member Bank the Right to Rediscount with Its Federal Reserve Bank?

Yes; provided the member bank has eligible paper to offer for rediscount, that is to say, paper which meets the requirements of the law, as laid down in the Federal Reserve Act, and of the regulations of the Federal Reserve Board, made in pursuance of the duties imposed and powers conferred on the Board by the Federal Reserve Act.

43. What Paper Is Eligible for Rediscount with a Federal Reserve Bank?

Notes, drafts, and bills of exchange, arising out of actual commercial transactions, or seasonal agricultural requirements, i.e., that are issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been or are to be used in producing, purchasing, carrying, or marketing goods in one or more of the steps of the process of production, manufacture, or distribution. Such notes, drafts, and bills of exchange issued or drawn for industrial or commercial purposes must have a maturity at the time of discount of not more than ninety days, exclusive of days of grace. Notes, drafts, and bills of exchange drawn or issued for agricultural purposes or based on live-stock must have a maturity at the time of discount of not exceeding six months, exclusive of days of grace. Any such paper may have been drawn for a longer time when discounted or purchased by the member bank, but the maturities must be not longer than ninety days for commercial and industrial paper and six months for agricultural or live-stock paper when offered for rediscount with a Federal reserve bank.

44. Is There Any Other Class of Paper Eligible for Rediscount?

Yes. Paper secured by United States bonds, Treasury certificates, or United States notes is eligible for rediscount provided its maturity is not beyond ninety days, exclusive of days of grace, at the time it is offered for rediscount.

45. What Paper Is Not Eligible for Rediscount?

Notes, drafts, or bills of exchange, the proceeds of which have been used or are to be used for permanent or fixed investments of any kind or for investments of a purely speculative character, are not eligible for rediscount.

46. Is a Note Otherwise Eligible Made Ineligible Because It Is Secured by Pledge of Collateral?

No. It may be secured by the pledge of goods or collateral and still be eligible for discount by a Federal reserve bank.

47. Is This Distinction Made for the Purpose of Discouraging Speculation or Speculative Investments?

No. But as the deposits of Federal reserve banks are mainly the reserve funds of member banks, their investments should be not only of short maturity but liquid beyond question. Therefore, it is the object of the regulations to define eligible paper as paper growing out of current commercial or agricultural transactions under conditions which will insure the liquidation of the paper at maturity. Moreover, since the paper rediscounted by Federal reserve banks is used as collateral for Federal reserve notes, it should be practically self-liquidating, so that any sudden contraction in the volume of outstanding Federal reserve notes can be met out of the proceeds of maturing paper.

48. Why Does a Federal Reserve Bank Rediscount Only Short-Time Paper?

Because the commercial banking experience of the world points conclusively to the wisdom of maintaining a highly liquid condition. The rediscounting of short-time, self-liquidating paper guarantees that a reserve bank will never be caught in such a position that it cannot supply currency and credit to any reasonable extent instantly and on demand. The central banks of the chief foreign countries follow the same practice of rediscounting only short-time and highly liquid paper. So well is this principle recognized that, since the founding of the reserve banks in the United States, the trend has been toward an increase of short-time paper. This is an advantage both to the reserve banks and their members. The shorter the paper, the more liquid are the reserve banks; and the shorter the paper, the more opportunities are afforded to the member banks to require curtailment or payment when necessary or practicable.

For this reason, no Federal reserve bank is allowed to rediscount industrial or commercial paper with a maturity longer than ninety days. As a matter of fact, the average maturity of the paper held by all Federal reserve banks is within thirty days. Agricultural paper, however, having not more than six months to run, is eligible for rediscount. This exception is made because of the well-known fact that crops cannot be planted, matured, and marketed within a shorter time. Notwithstanding this fact, many farmers have adopted the practice of giving short-time notes, even with the certainty of having to renew in many cases before the completion of the operations financed by them. This is a result of the growing certainty on the part of the farmer of obtaining adequate help throughout the entire season, and this certainty is a result of the proper functioning of the Federal reserve banks.

49. Is All Eligible Paper Acceptable?

Paper which is technically eligible under the regulations is not necessarily acceptable, since the officers and directors of Federal reserve banks are clothed with full authority to determine whether or not paper offered for rediscount is satisfactory. In addition, the regulations provide that, in case a borrower's statement is necessary, the paper of the borrower is eligible only in the event that the statement shows a reasonable excess of quick assets over current liabilities. What constitutes a reasonable excess will depend upon the nature of the business, the time of the year in which the statement is made, and other circumstances disclosed by the statement. The officers of a Federal reserve bank have, of course, the right to require such additional information with reference to paper offered as may seem necessary to them.

50. How Does a Federal Reserve Bank Determine Whether or Not Paper Offered to It for Rediscount Is Eligible?

The member bank offering paper for rediscount is required to list it on a regular offering sheet furnished by the Federal reserve bank. On this sheet are various columns in which certain information with reference to each note is required to be given. Directions printed on the sheet show plainly and clearly what information is required and how the sheet is to be filled out. Furthermore, in signing the application for the rediscounts on the sheet, a duly authorized officer of the applying member bank certifies that, to the best of his knowledge and belief, the paper is eligible under the law and the regulations of the Federal Reserve Board.

51. Is It a Difficult or Complicated Matter to Secure and Furnish the Information Required by a Federal Reserve Bank in Connection with Paper Offered for Rediscount?

No information with reference to paper offered for rediscount is required by a Federal reserve bank except such as a prudent officer of the offering bank should have in his possession before discounting or purchasing the paper for his bank, and any officer having this information at his command should have no difficulty in properly filling out the rediscount application sheet.

52. When and in What Form Are Borrowers' Statements Required in Connection with Paper Offered for Rediscount?

When the member bank is lending to any one borrower as much as $5,000 (or, in the case of a bank with a capital of less than $50,000, an amount equal to ten per cent. of its own capital stock), the bank should have in its files a signed statement of the assets and liabilities of the borrower. Moreover, these statements should be renewed at least once a year. When any paper of such a borrower is offered for rediscount, the member bank should send with the offering a copy of the borrower's statement, certified to by some officer of the bank as being a true copy of a signed statement in the files of the bank. Having once filed a certified copy of a borrower's statement with a Federal reserve bank, it is, of course, unnecessary to furnish another copy until the first is a year old, or until a new statement is requested by the Federal reserve bank. This requirement of borrowers' statements in connection with paper offered for rediscount has enabled member banks to secure many statements from borrowers heretofore unobtainable. We have had evidences of many cases in which member banks have saved themselves from serious losses by examination of statements so obtained.

53. Are Statements Required in Any Other Cases?

Statements are sometimes required even where the total amount loaned to the borrower by the member bank is less than $5,000, or ten per cent. of the capital of the member bank, where such capital is less than $50,000. The officers and directors of a Federal reserve bank are supposed to be careful and prudent in the rediscounting of paper, and the law and the regulations give them the right to ask for such information with respect to each loan as they may deem it prudent to require. At the same time it is not the policy of the Federal Reserve Bank of Richmond to be in any way unreasonable, or to insist upon the production of a statement unless the circumstances connected with the particular transaction are such as to make it seem necessary.

54. When a Member Bank Files with Its Federal Reserve Bank a Statement of One of Its Customers, Is the Information Regarded as Confidential?

Not only statements, but all other forms of credit information furnished to a Federal reserve bank by a member bank are looked upon as confidential by the Federal reserve bank. While its officers, of course, feel entirely free to use the information furnished by one bank for the purpose of passing upon paper offered by another bank, no information given by one bank is communicated to another bank without the express permission of the bank from which the information is received. All statements and other credit information are kept in a special credit file, under the charge of the manager of the credit department, and only the officers and employees directly engaged in credit work are at liberty to examine the file.

55. Is There Any Limit upon the Amount That a Member Bank May Rediscount with Its Federal Reserve Bank?

While the law sets no limit, it is within the power of the officers of a Federal reserve bank to decide each case separately and to determine to what extent credit should be extended to the applying member. In such determination, they are expected to be impartially guided by sound banking principles, the conditions surrounding the applying bank, and the purpose for which the proceeds are to be used.

56. What Additional Reason Is There for Limiting the Amount That Any Member Bank May Rediscount with Its Federal Reserve Bank?

Section Four of the Federal Reserve Act provides that:

> "SAID BOARD [*of directors*] *shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks and shall, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements, and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks.*"

Therefore, if any member bank is borrowing from its Federal reserve bank an amount considerably greater than it would be able to obtain if all member banks were asking for their share of available credit at the same time, it is in a position where curtailment might have to be required, in case requests for loans or rediscounts were simultaneously made by a considerable number of other member banks and a generally expanded condition thus produced.

57. Under What Circumstances and to What Extent Does the Federal Reserve Bank of Richmond Require Marginal Collateral?

Section 5,202 of the National Bank Act provides that no national bank shall borrow an amount exceeding the amount of its paid-in capital stock. Certain exceptions are made, however, and one of these exceptions is, "Liabilities incurred under the provisions of the Federal Reserve Act."

Therefore, a member bank is allowed to exceed the limit, if necessary, with respect to loans from or rediscounts with its Federal reserve bank. At the same time, the exception was not made in abnegation of the principle but in order that a Federal reserve bank might be in a position to extend to a member bank in an emergency any degree of assistance which it might require and which the officers of the Federal reserve bank might consider necessary and safe. The Federal Reserve Bank of Richmond has adopted the policy of requiring marginal collateral from any member bank whose total borrowings (exclusive of notes secured by Government paper), including loans from other banks as well as the Federal reserve bank, exceed the amount of the member bank's capital. In case the member bank has a large surplus in proportion to its capital, the request is not always made as soon as the total reaches the amount of the capital. The amount of marginal collateral depends upon circumstances. It is customary to ask for twenty-five per cent. (of the total amount borrowed from the Federal reserve bank) when the amount of capital is exceeded, and to increase the percentage if the amount of capital is considerably exceeded. This rule is applied uniformly and impartially to all member banks.

58. Is It Sound Practice for a Member Bank to Borrow from Its Federal Reserve Bank for the Purpose of Relending at a Profit?

Such a practice is extremely unsound. Generally speaking, a bank should limit the amount of its loans to its own resources and reserve its borrowing power with its Federal reserve bank to meet emergencies, such as an unexpected shrinkage of deposits, or to meet the increased demands of its regular customers during the season or seasons when their legitimate requirements exceed the resources of the bank. In other words, every bank should "clean up" all its obligations for bills payable or rediscounted paper at least once or twice in each year. By so doing it will materially increase its capacity to expand its loans during the season or seasons when the demands of its customers are normally heaviest.

59. May a Member Bank Borrow from Its Federal Reserve Bank on Its Own Note?

Yes. The Federal Reserve Act provides that any Federal reserve bank may make advances to its member banks on their promissory notes for a period not exceeding fifteen days, provided such promissory notes are secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of the Act and the regulations of the Federal Reserve Board, or by the deposit or pledge of bonds or notes of the United States.

60. Are Such Notes Subject to Renewal?

The privilege of borrowing in this way was granted to member banks to enable them to secure short-time advances even when they did not happen to have paper eligible for rediscount maturing within the required time. The privilege was not given for the purpose of substituting this form of obligation for rediscounted paper. Therefore, such notes are not supposed to be renewed, though the paper securing them may be rediscounted, if necessary, at the maturity of the note. However, during the period in which banks were called upon to assist in Government financing, it was necessary for them to rediscount very freely with their Federal reserve banks, and fifteen-day notes *secured by Government obligations* have been freely renewed. This practice will doubtless be continued as long as it may be necessary.

61. How Does the Federal Reserve Bank Collect Notes Rediscounted with It?

When notes are rediscounted with the Federal reserve bank, the discount is calculated up to the day of maturity. Approximately ten days before that date, the notes are sent for collection to the member bank for which they were discounted and on the maturity date the face value of the notes is charged to the reserve account of the member bank. Wherever the member bank wishes the Federal reserve bank to collect the notes, they are turned over to the collection department ten days before maturity, and at maturity they are charged to the reserve account of the member bank; but when returns are received on the notes entered for collection, credit is, of course, given in the reserve account of the member bank. By this method, it is unnecessary to approximate and include, at the time the notes are rediscounted, the time necessary for collection, or to include a special charge covering any possible exchange which may be made by the collecting bank. As a matter of fact, the practice of returning notes to the member banks for collection has proved entirely satisfactory, as it enables the bank to make its own arrangements for collection and returns.

62. How Are the Discount Rates of a Federal Reserve Bank Determined?

The law provides that the discount rates for each Federal reserve bank shall be fixed by the board of directors of the bank, subject to review and determination by the Federal Reserve Board. As a matter of practice, discount rates vary slightly with different classes of paper and sometimes for different maturities. Whenever a change is made in one or more rates by a Federal reserve bank, the change is submitted to the Federal Reserve Board for approval, and, after such approval has been obtained, all member banks are advised not only of the new rate but of all rates existing at the time. These rates are applicable impartially to all member banks whether large or small.

By an amendment to the Federal Reserve Act, approved April 13, 1920, Federal reserve banks are permitted to establish graduated or progressive discount rates, that is to say, rates which may be graduated or progressed on the basis of the amount of the advances and discount accommodations extended by the Federal reserve bank to the borrowing bank. If and when graduated or progressive discount rates are established by a Federal reserve bank, a basic amount is determined for each member bank, taking into consideration the average reserve deposit of the member bank for a given past period and the amount paid in by the member bank on its subscription to the capital stock of the Federal reserve bank. The regular published discount rate is charged on loans and rediscounts up to the basic amount and, on additional amounts borrowed, a progressively higher rate is charged in accordance with the terms fixed by the Federal reserve bank and approved by the Federal Reserve Board in establishing the progressive rates.

63. Will the Federal Reserve Bank Hold Securities in Custody for Its Members?

Yes. The Federal reserve bank is prepared to hold Liberty bonds, Victory notes, Treasury certificates of indebtedness, or other Government securities in custody for member banks without charge. Moreover, it will remove coupons as they mature, collect, and credit them to the reserve account of the member bank, in every case advising the amount credited.

BANKERS' ACCEPTANCES.

64. What Are Bankers' Acceptances and upon What Conditions Are Member Banks Authorized by Law to Accept?

This subject is a very intricate one, and it is further complicated by the fact that, until the passage of the Federal Reserve Act, national banks were not allowed to accept. Moreover, the law prescribing the conditions under which acceptances can be discounted or purchased by Federal reserve banks is subject to modification by regulations and rulings of the Federal Reserve Board. This subject will be covered in a special booklet on Bankers' Acceptances to be issued by the Federal Reserve Bank of Richmond.

V. Reserves of Member Banks

RESERVES REQUIRED.

65. What Are the Reserves Required to Be Carried by Member Banks with a Federal Reserve Bank?

Every member bank is required to establish and maintain a reserve balance with its Federal reserve bank as follows:

(1) If it *is not located in a reserve or central reserve city, an actual net balance equal to seven per cent. of its net demand deposits (as defined in Question No.* 67) *and three per cent. of time deposits (as defined in Question No.* 68).

(2) If *in a reserve city, ten per cent. of net demand deposits and three per cent. of time deposits.*

(3) If *in a central reserve city, thirteen per cent. of net demand deposits and three per cent. of time deposits.*

66. What Are the Reserve Cities in the Fifth Federal Reserve District?

Richmond, Virginia; Baltimore, Maryland; Washington, District of Columbia; and Charleston, South Carolina. There is no central reserve city in the Fifth Federal Reserve District.

DEPOSITS.

67. What Are Demand Deposits?

Demand deposits comprise all deposits payable within thirty days.

68. What Are Time Deposits?

Time deposits comprise all deposits payable after thirty days, savings accounts subject to not less than thirty days' notice, time certificates of deposit until within thirty days of their maturity, and all postal savings deposits.

69. Must Reserves Be Carried Against All Deposits?

Reserves must be carried against all deposits, including state, county, municipal, and postal savings deposits, except secured deposits of the United States, other than postal savings deposits.

70. How Is the Reserve of a Member Bank Calculated?

A form showing the method of computing the reserve to be carried by a member bank will be found in the Appendix hereto.

71. Can a Member Bank Check on Its Reserve Account with Its Federal Reserve Bank?

Member banks are not only allowed but encouraged to check on their accounts with their Federal reserve bank, provided the realized reserve balance is not reduced below the point required by law. If the balance is reduced below that which the member bank is required by law to maintain, the Federal reserve bank is required by law and the regulations of the Federal Reserve Board to assess a penalty against the member bank for deficiency in its reserve. The law provides further that no bank whose reserve is deficient shall make new loans or pay any dividends until the total balance required by law is fully restored.

DEFICIENCIES IN RESERVE.

72. What Is the Penalty for a Deficient Reserve?

At present the penalty prescribed by the Federal Reserve Board is an amount equal to an interest charge at a rate two per cent. above the current discount rate for ninety-day commercial paper. The regulations of the Board provide further that an additional penalty may be imposed in case a member bank is repeatedly deficient in its reserve.

73. How Is the Penalty Assessed?

Member banks located in reserve or central reserve cities are required to make weekly reports to their Federal reserve bank. These reports show net demand deposits, time deposits, and required reserve. Banks not located in a reserve or central reserve city are required to make such reports semi-monthly, covering, respectively, the first and second half of each month. The Federal reserve bank maintains a record showing the daily balance on the available reserve account of each member bank. The average required reserve for the calendar week and the average actual reserve for the same period are compared for banks located in reserve cities, and the average deficiency for the week is thus determined. In the case of a bank not located in a reserve or central reserve city, the averages are taken for semi-monthly periods. Penalties are assessed upon the basis of these comparisons, and itemized bills are sent monthly to member banks whose reserve accounts have become deficient. For further particulars see our Circular No. 89, Revised.

74. What Is the Purpose of the Penalty for Deficient Reserves?

Penalties for deficiencies in reserves are assessed for the purpose of discouraging banks from depleting their reserve accounts when called upon to meet unexpected demands which can be provided for by rediscounting paper with the Federal reserve bank. From the answers to several of the preceding questions, it will be perfectly evident that the lending power of a Federal reserve bank is affected far more by checking against a reserve account than by rediscounting paper to the same amount. To be exact, $1,000 withdrawn from a reserve account affects the lending power of a Federal reserve bank to the extent of $1,625.

75. How May the Reserve Account of a Member Bank Be Opened?

The reserve account may be opened in any of the following ways:

(1) BY DEPOSITING *gold, lawful money, or Federal reserve notes with the Federal reserve bank.*

(2) BY DEPOSITING *checks drawn on correspondents on the Federal reserve bank's par list or by a deposit by a correspondent with any Federal reserve bank or branch for the credit of the applying bank with its Federal reserve bank.*

(3) BY REDISCOUNTING *with the Federal reserve bank.*

76. For What Items Is Immediate Credit Given?

Immediate credit will be given for gold, gold certificates, silver certificates, United States notes, Federal reserve notes, Federal reserve bank notes, the proceeds of paper rediscounted, checks drawn on the Treasurer of the United States, and, in Richmond, for checks drawn on banks in Richmond, Virginia, or, in Baltimore, for checks drawn on banks in that city. Immediate credit is not given for checks on out-of-town banks (except those bearing the Immediate Credit Symbol, see Questions Nos. 99 to 101) because the Federal reserve bank cannot count as reserve items in transit, but only collected funds.

77. How May a Member Bank Keep Track of the Balance to Its Credit on the Books of the Federal Reserve Bank?

By charging the items sent to the Federal reserve bank in a special account on its general ledger, and transferring such charges to its reserve account upon the exact dates on which credit will be given by the Federal reserve bank. These dates will be indicated in acknowledgments of receipt sent out by the Federal reserve bank. Of course, credits to reserve account should be made in the same way. Further suggestions with reference to, and proper maintenance of, a reserve account will be found in our Circular No. 45-b.

78. Are There Any Limitations upon the Deposits Which a Member Bank May Keep with Other Banks?

No member bank may keep on deposit with any state bank or trust company, which is not a member bank, a sum in excess of ten per cent. of its own paid-up capital and surplus.

VI. Collections, Transfers, and Currency Shipments

79. Does the Federal Reserve Bank of Richmond Maintain a Collection Department?

Yes. Through this department, checks and drafts drawn upon national banks, all state bank members, and all non-members, whose names appear on the par list, can be collected and credited without expense to or deduction from the accounts of member banks. Through another department, bills, notes, drafts, and other time items can be collected and the proceeds credited upon receipt.

COLLECTION SYSTEM.

80. What Checks or Drafts Will Be Received by the Federal Reserve Bank of Richmond for Collection?

Checks and drafts on Federal reserve banks and their branches, on all member banks in the United States, whether national or state banks, and on all non-member banks in the United States, upon which checks can be collected at par, will be received for collection by the Federal Reserve Bank of Richmond. Checks on non-member banks whose names are not on the par list are not received for collection.

81. What Is the Par List?

In addition to all national banks and state bank members, a very large proportion of the state banks (not members of the Federal Reserve System) have agreed to remit at par for checks drawn upon them. The names of the state banks on the par list are published twice a year by the Federal Reserve Board, and changes are noted each month in a supplement issued in connection with the *Federal Reserve Bulletin* published by the Federal Reserve Board. Copies of the par list and supplements (bringing the par list down to date) will be furnished to any bank on application.

82. What Proportion of Banks in the United States Is on the Par List?

More than ninety per cent.

83. What Proportion of Banks in the Fifth Federal Reserve District Is on the Par List?

Sixty-four per cent. There are 2,143 banks in the District, of which 1,367 are on the par list. These figures are as of June 30, 1920.

84. How Should Checks Be Sent to the Federal Reserve Bank for Collection?

Checks should be sent to the Federal reserve bank for collection in regular cash letters, and, where the number of checks sent at any one time is considerable, a separate letter should be made up for each maturity (see time schedule), and only checks available on the same maturity date should be included in one letter. That is to say, items acceptable for immediate credit should be included in one letter; items available one day after receipt (see time schedule), in another letter; items available two days after receipt, in another letter; and so on. Where the items sent are few in number, a single letter form may be used; but on this form the items should be grouped as to maturities, with one total for immediate credit items, another for items available one day after receipt, another for items available two days after receipt, and so on. The Federal reserve bank will acknowledge receipt of all such sendings, and the acknowledgment slip will indicate the day upon which each amount is to be credited in the reserve account of the member bank. As stated under Question No. 85, there is no difficulty whatever in the operation of this plan.

85. When Is Credit Given for Checks on Banks on the Par List Which Are Sent to the Federal Reserve Bank by a Member Bank?

The Federal reserve bank issues a time schedule which embraces all points upon which collection can be made. This schedule is divided into various sections, designated as "immediate credit," "one day," "two day," "three day" points, etc. All items in the "immediate credit" section are credited immediately to the reserve account of the member bank. Other items are credited to the deferred credit account of the member bank and transferred to the reserve account after the lapse of time indicated in the time schedule. This plan is entirely simple in operation.

86. Why Is Not Immediate Credit Given for All Items as Soon as They Are Received?

Because items in transit are not money and cannot be counted as reserve by a Federal reserve bank until they are converted into money. Some of these items require one day, some two days, some three days, and so on. The volume of items in transit is what is technically known as "float." One of the most serious defects of the old National Banking System was that items in transit could be counted as reserve, with the result that, whenever circumstances required reserves to be drawn on, the system broke down because such a large part of the reserve had no real existence. In eliminating the practice of counting float as reserve, the Federal Reserve System has merely squared theory with facts and made impossible a condition which was always productive of disaster in time of trouble.

87. Are Any Charges Made for Collecting Checks?

No.

88. Are Any Charges Made for Collecting Bills, Notes, Coupons and Other Items?

No charge is made by the Federal reserve bank to member banks for making time collections payable in any city in which there is a Federal reserve bank or branch. Time collection items payable in other cities are subject to the exchange charge made by the collecting bank at the point of payment. The Federal reserve banks, however, make a charge of fifteen cents per item for all drafts, notes, etc., returned unpaid. The purpose of this charge is to prevent the use of the Federal reserve bank for transmitting dunning drafts, and not to make money or cover expenses.

89. When Are Checks That Are Drawn on Member Banks and Sent to Them by Federal Reserve Banks Charged to Their Reserve Account?

All checks drawn on a member bank and sent for collection to or through a Federal reserve bank are dispatched by the Federal reserve bank direct to the member bank on the day of receipt. When these letters are dispatched they are charged by the Federal reserve bank to a deferred debit account, and the charge is transferred to the reserve account of the member bank (on which the checks are drawn) on the first day upon which returns could be received from the member bank, provided they are made promptly upon receipt of the items by the member bank. Proper allowance for delays in the mails is always made upon receipt of advice of such delays from the member bank. For further particulars see our Circular No. 89—Revised.

90. What Is Meant by the Direct Routing of Checks?

It frequently happens that a member bank is so situated that it can dispatch items payable in another Federal reserve district direct to the Federal reserve bank (or branch) of that district, and save considerable time thereby. Where the member bank has items of considerable size, or a considerable number of items which can be handled in this way, direct routing is encouraged. No member bank, however, should undertake the practice of routing items direct to another Federal reserve bank (or branch) without first communicating with its own Federal reserve bank and obtaining permission to do so. At the time this permission is granted full directions will be given and sample forms furnished. It is absolutely necessary that these directions be followed and that proper forms be used in order to insure the prompt receipt of credit by the member bank in its reserve account with its own Federal reserve bank.

ADVANTAGES OF COLLECTION SYSTEM.

91. What Are the Advantages of Collecting Checks Through the Federal Reserve Bank?

First, greater economy in collecting these items and avoidance of the necessity of maintaining balances with correspondents in various cities in order to obtain check collection facilities.

Second, most direct routing of items possible, with a corresponding reduction in the length of time items are outstanding. This results in the elimination or reduction of float and enables member banks and their customers to learn at the earliest possible moment whether items have been paid or dishonored, and to have the funds represented by the items available for use more quickly.

92. How Has the Collection System of the Federal Reserve Banks Benefited Industry and Commerce?

First, by shortening the time necessary to make collections. Under the old system it was necessary for an item to reach its destination and the returns to come back; and, as these returns were usually in the shape of a bank draft on some other point, an additional period of one or more days was necessary to complete the transaction. By the establishment of the twelve Federal reserve banks and their branches, and by the inauguration of settlements by wire through the leased wire system (which connects all the reserve banks and their branches), payment is obtained in most cases in one-half of the original time.

Second, by concentration of an enormous volume of items in one system, the volume travelling in one direction is largely offset by the volume going in the other direction. A still further economy in this respect is gained by the fact that all Federal reserve banks and branches are included in one daily settlement made by means of wire advices. The effect of this system is to reduce to a minimum the necessity for the transfer of actual money in the settlement of exchanges.

Third, the necessity for the transfer of money to make settlement is still further reduced and practically eliminated by the establishment of the Gold Settlement Fund in Washington, which is participated in by all Federal reserve banks and, either directly or indirectly, by their branches. This enormous saving to the business interests of the country in time and in the expense covering the cost and risk of the transportation of money is due to the collection system of the Federal reserve banks.

93. To What Extent Are the Banks of the Fifth District Making Use of the Collection System?

In 1918 the total number of checks handled by the transit department of the Federal Reserve Bank of Richmond (including that of the Baltimore Branch) was 12,020,068, amounting to more than seven billions of dollars. The total number of checks handled in 1919 was 20,934,355, amounting to more than nine billions of dollars. The daily average in 1918 was 39,540 checks, amounting to $23,399,000, while the daily average in 1919 was 69,319 checks, amounting to $30,808,000. In addition to this enormous volume of clearing operations during 1919, there were handled 79,627 direct routing letters containing items aggregating more than $1,500,-000,000.

TRANSFERS OF FUNDS.

94. How May Member Banks Use the Federal Reserve Bank for the Transfer of Funds?

In two ways: by wire transfers, and by Federal reserve exchange drafts.

95. How May Wire Transfers Be Made?

A member bank may make wire transfers without cost through its Federal reserve bank to any other Federal reserve bank or branch for its credit with any member bank. Telegrams addressed to the Federal reserve bank for this purpose may be sent "collect." Or the member bank may request its correspondent in another district to make a transfer to its own Federal reserve bank for its own use of funds which it has to its credit with its correspondent. The correspondent, if a member of the Federal Reserve System, can effect the transfer immediately and without cost to itself. All Federal reserve banks and branches are connected by leased wires which enable them to make these transfers promptly and without charge.

96. What Are Federal Reserve Exchange Drafts?

Any member bank may make arrangements with its Federal reserve bank to draw drafts upon it, using a special form provided for this purpose by the Federal reserve bank. Such drafts are known as "Federal Reserve Exchange Drafts," and will be accepted for immediate credit, but subject to final payment by any other Federal reserve bank or branch. The member bank issuing such drafts agrees to notify its Federal reserve bank of all drafts so issued, using a special advice form for the purpose, which form is mailed upon the day upon which the drafts are issued. Upon receipt of this form, the Federal reserve bank charges the drafts to the account of the member bank and holds the funds to meet the drafts when presented for payment. Any Federal reserve bank or branch paying such a draft can immediately reimburse itself through the Gold Settlement Fund, through which settlements are made daily, and the actual drafts are forwarded by mail to the Federal reserve bank or branch upon which they are drawn. Up to this time, Federal reserve exchange drafts cannot be drawn for amounts greater than $5,000 each. For further information with reference to this subject, see our Circular No. 81.

CURRENCY SHIPMENTS.

97. What Facilities in Shipping Currency Does the Federal Reserve Bank of Richmond Afford?

Shipments of gold coin and gold certificates may be made to the Federal Reserve Bank of Richmond by either member or non-member banks and the transportation cost will be borne by the Federal reserve bank, provided the regulations for making such shipments are observed by the shipping bank. Mutilated gold coin will be accepted at bullion value, but, until further notice, the cost of abrasion from ordinary use will be absorbed by the Federal reserve bank. Transportation charges on shipments of currrency to and from member banks only will be borne by the Federal Reserve Bank of Richmond, provided the regulations with respect to sealing and shipment are duly observed. And, until further notice, the cost of necessary telegrams relating to such shipments will also be paid by the Federal Reserve Bank of Richmond. National bank notes should not be sent to the Federal reserve bank for exchange or redemption; such shipments should be made to Washington as heretofore. For further information on this subject, see our Circular No. 84.

98. Are Member Banks Located in a City in Which There Is a Federal Reserve Bank or Branch in a Position to Offer Special Advantages to Country Banks Maintaining Accounts with Them?

This is naturally the case. If the country bank is a member of the Federal Reserve System its check on its correspondent located in a Federal reserve city (or branch city) is acceptable for immediate credit by the Federal reserve bank (or branch) located in the same city. Country banks that are not members of the System, but that are on the Federal reserve par list, can use checks on these city correspondents in remitting for items forwarded to them by the Federal reserve bank of the district.

IMMEDIATE CREDIT SYMBOL.

99. What Facility, if Any, Has the Federal Reserve Bank of Richmond Provided by Which Member Banks Located in Other Cities Can Overcome This Inequality?

The Federal Reserve Bank of Richmond has offered to its member banks, and particularly to those carrying the accounts of other banks, the use of the Immediate Credit Symbol. Checks bearing this symbol are acceptable for immediate credit by the Federal Reserve Bank of Richmond and, therefore, can be used by country banks to promptly replenish their reserves, or to cover checks drawn upon them and sent to them by the Federal Reserve Bank of Richmond. By this means banks located in cities other than a Federal reserve or branch city can offer the same advantages to their bank customers that can be offered by the bank located in the Federal reserve or branch city.

100. Explain the Nature and Use of the Immediate Credit Symbol.

The Immediate Credit Symbol, of which an illustration is given in the accompanying cut, is a copyrighted symbol, the use of which is controlled by the Federal Reserve Board and the Federal reserve bank. A member bank desiring to obtain the privilege of granting to its customers the right to use this symbol upon checks drawn upon it must apply to its Federal reserve bank for permission to do so. The member bank is then required to sign a contract agreeing to certain conditions which are necessary to insure the proper use of the symbol. One of these conditions is that the right to use the symbol can be granted to one of its customers only upon the customer's signing a contract with the member bank. This contract is designed also to insure the proper use of the symbol. The customer, usually a country bank, to whom the right to use the symbol has been granted, can then affix it to any or all of the checks

drawn by him on the member bank through which the right to use the symbol is granted.

These checks are accepted for immediate credit by the Federal reserve bank or branch indicated in the symbol, and, under an arrangement covered in the contract with the member bank on which they are drawn, they are charged immediately to the reserve account of that bank. Other checks not bearing the immediate credit symbol are, of course, sent in the usual way, and charged only after the expiration of the proper transit time. For further particulars see our Circular No. 93.

101. Can the Immediate Credit Symbol Be Used on Checks Which Are to Be Sent Out of the District?

It can be so used, but wherever the amount invoived is considerable we would strongly advise that the customer bank communicate with its member bank correspondent direct and ask that the payment be made in the other district by a wire transfer, and when the amount is very large a transfer by wire should always be made. This can be accomplished promptly and with little or no expense, and the member bank on which the draft is made will have the opportunity to protect its own reserve account more promptly and more effectually. Moreover, until the banks in other districts become more familiar with the use of the symbol and learn that they can obtain credit for a check bearing the symbol in the same time that credit can be obtained for a check drawn on a bank in the Federal reserve city indicated in the symbol, there is danger that the person remitting by this means may not obtain the full advantage which should accrue to the use of the symbol.

VII. State Bank and Trust Company Membership

In this section of this book we endeavor to group the questions and answers relating specifically to state bank and trust company membership in the Federal Reserve System. State banks and trust companies contemplating membership and those that are already members will find many matters of interest in the preceding sections of the book, which deal with the relations between a Federal reserve bank and its member banks. It is manifestly unnecessary to repeat or duplicate that information in the following section.

ELIGIBILITY—TESTS—CHARTER RIGHTS.

102. What State Banks and Trust Companies Are Eligible for Membership?

Any bank or trust company incorporated by a special law of any state, or organized under the general laws of any state, and having a paid-up, unimpaired capital stock at least equal in amount to that which would be required of a national bank in the same place, is eligible for membership. The capital requirements of national banks (and state banks applying for membership) are as follows:

In cities or towns not exceeding 3,000 inhabitants........................$25,000.
In cities or towns exceeding 3,000 but not exceeding 6,000 inhabitants........... 50,000.

In cities or towns exceeding 6,000 but not
exceeding 50,000 inhabitants..........$100,000
In cities exceeding 50,000 inhabitants.....200,000

103. What Tests Are Applied in Considering the Application of a State Bank or Trust Company for Membership?

First, the financial condition and the character of the management of the applying institution.

Second, whether the powers authorized in its charter and exercised by it are consistent with the Federal Reserve Act.

Third, whether the laws of the state in which the applying bank or trust company is located contain provisions likely to prevent its proper compliance with the provisions of the Federal Reserve Act. The present laws of the states embraced in the Fifth Federal Reserve District contain no such provisions.

104. If, When a State Bank Applies for Membership, It Appears That There Are Provisions in Its Charter, or Conditions Existing in the Bank Which Are Inconsistent with Membership in the Federal Reserve System, Is the Application Refused?

Not necessarily. In such case, unless the objection is radical, the application is accepted on condition that the officers and directors of the applying bank agree to certain conditions laid down by the Federal Reserve Board for the purpose of overcoming the objection. In every case the applying bank is given ample time and opportunity to consider these conditions.

105. Does a State Bank or Trust Company Retain Its Charter Rights When It Becomes a Member?

Yes. It retains its full charter and statutory rights as a state bank or trust company. It is subject to the provisions of the Federal Reserve Act, which relate specifically to member banks, and to the regulations of the Federal Reserve Board, and must conform to those provisions of law imposed on national banks which prohibit such banks from lending on or purchasing their own stock, which relate to the withdrawal or impairment of their capital stock, and which relate to the payment of unearned dividends; but otherwise a state bank member is permitted to exercise any charter rights not in conflict with the Federal Reserve Act or regulations of the Federal Reserve Board.

PROCEDURE.

106. What Is the Procedure for Becoming a Member of the Federal Reserve System?

First, the adoption by the board of directors of a resolution making application for stock in the Federal reserve bank (F. R. B.—Form 83-a).

Second, formal application for the requisite number of shares with agreement to pay for them and to comply with the requirements of the Federal Reserve Act, etc. (F. R. B.—Form 83-a).

Third, the three following exhibits are to be attached to the application:

EXHIBIT ONE: *A statement of condition as of a given date, signed by three directors and duly certified by the cashier or secretary.*

EXHIBIT TWO: *A certified copy of charter or articles of incorporation of the corporation, with amendments.*

EXHIBIT THREE: *A statement containing certain supplementary information* (*Supplement to F. R. B.—Form* 83-*a*).

All necessary forms will be furnished on request.

Whenever it is possible to do so, duplicate copies of the report of the last examination of the applying bank or trust company made by the state banking department, together with copies of all correspondence relating thereto, should accompany the application. Whenever it is practicable to do so, a representative of the Federal Reserve Bank of Richmond will be sent without expense to the applying bank to assist in preparing the papers necessary in connection with the application for membership.

On completion of the application, all the necessary papers and documents are examined by the executive committee of the Federal Reserve Bank of Richmond and forwarded to the Federal Reserve Board in Washington, with the formal recommendation of the committee. The decision of the Federal Reserve Board is transmitted in the form of an official letter through the Federal Reserve Agent to the applying bank, which usually forwards its acknowledgment and acceptance by wire.

The Federal Reserve Board then instructs the Federal Reserve Bank of Richmond to proceed with the completion of the membership, and the Federal Reserve Bank of Richmond communicates with the applying bank with reference to the deposit of its required reserve and payments upon its application for capital stock. The officers and executive committee of the Federal Reserve Bank of Richmond endeavor to handle all applications as promptly as possible, and, should any matters arise necessitating correspondence, the applying bank is notified at once.

107. How May the Reserve Account of a Member Bank Be Opened?

For answer to this question, see Question No. 75 on page 46.

108. For How Much Stock Must a Member Bank Subscribe?

For an amount equal to six per cent. of its paid-up capital and surplus. One half of the subscription must be paid in at once; the other half is subject to the call of the Federal Reserve Board. No call has yet been issued for any part of the second half of any member bank's subscription. If a member bank increases or decreases its capital stock or surplus, it must increase or decrease accordingly its stock in its Federal reserve bank.

109. If a State Bank Is Permitted by the Law of Its State to Lend to Any One Person an Amount Greater Than Ten Per Cent. of Its Capital Stock, Does It Give Up This Right by Becoming a Member?

No. The loan limit under the state law is not interfered with, but a state bank member may not rediscount with the Federal reserve bank any of the paper of a borrower who is liable to it in an amount in excess of ten per cent. of its unimpaired capital and surplus unless all of such borrower's paper offered for rediscount is secured by not less than a like face amount of bonds or notes of the United States, issued since April 24, 1917, or certificates of indebtedness of the United States, but in no event more than twenty per cent. This provision as to paper secured by Government obligations will become inoperative on December 31, 1920. A state bank member may, however, rediscount eligible notes of other borrowers.

REPORTS—EXAMINATIONS—WITHDRAWALS.

110. Does a State Bank or Trust Company Which Is a Member of the Federal Reserve System Make Reports to the Comptroller of the Currency, or Is It Subject to Examination by the Comptroller of the Currency?

No. State banks and trust companies which are members of the System are not in any way under the jurisdiction of the Comptroller of the Currency. They are required to make in each year not less than three reports of condition to the Federal reserve bank of which they are members, on dates to be fixed by the Federal Reserve Board, and semi-annual reports of earnings and dividends. No publication of these reports is required. In order to prevent duplication of work, they are usually called for as of dates upon which statements are called for by the state banking departments.

All member banks are required to make semi-monthly reports of reserve condition upon forms provided by the Federal reserve banks. This is necessary in order to enable the Federal reserve banks to determine whether proper reserve balances are being maintained. These reports are very simple, and the labor involved is slight. Member banks in reserve and central reserve cities are required to make these reports weekly, instead of semi-monthly.

111. To What Examinations Would a State Bank or Trust Company Member Be Subject?

State bank members are subject to examinations made by direction of the Federal Reserve Board or the Federal reserve bank by examiners selected or approved by the Federal Reserve Board. But, in order to avoid duplication, examinations made by state authorities are accepted by the Federal reserve bank, so that, except as noted in the next succeeding answer (see Question No. 112), no special examinations are made, and member banks are not subject to additional expense for examinations.

The Federal Reserve Bank of Richmond has made a practice of co-operating with the state bank examiners in the Fifth District and frequently furnishes one or more examiners to assist in the examination made by the state banking department. The state bank member in such case is subject to no additional expense for the examination.

112. Then Membership Would Not Involve Extra Examination?

Not necessarily; but the Federal reserve bank may, of course, at any time make a special examination, should the necessity arise. These cases, however, are rare, and whenever such special examinations are made they are of marked benefit to the member bank, and are so appreciated.

113. May a State Bank Withdraw from Membership in a Federal Reserve Bank?

Yes, upon giving six months' written notice to the Federal Reserve Board. The only other restriction upon withdrawal of a state bank is the provision of the Federal Reserve Act, which does not permit any Federal reserve bank, except upon express authority of the Federal Reserve Board, to cancel within the same calendar year more than twenty-five per cent. of its capital stock for the purpose of effecting voluntary withdrawals during that year. Applications for withdrawal must be dealt with in the order in which they are filed with the Board.

114. What Becomes of the Stock in a Federal Reserve Bank Held by a State Bank That Ceases to Be a Member?

The stock is surrendered and cancelled and the member bank receives a sum equal to the amount paid in on its subscription and one-half of one per cent. per month from the date of the last dividend, but not to exceed the book value of the stock (in case the earnings of the Federal reserve bank are not sufficient to pay the one-half of one per cent. per month), less any liability of the bank to the Federal reserve bank.

115. May a Bank Forfeit Its Membership?

Yes. The Federal reserve bank may require a bank which fails to comply with the provisions of the law or the regulations of the Federal Reserve Board to surrender its stock in the Federal reserve bank and forfeit all rights and privileges of membership; but membership may be restored upon proof of compliance with the conditions imposed.

STATE RESERVE REQUIREMENTS.

116. What Are the State Reserve Requirements for State Banks in This District?

District of Columbia: No specific law with reference to reserves.

Maryland: Banks of discount and deposit must keep on hand a reserve of five per cent. of their demand deposits in cash and an additional reserve of ten per cent. of such deposits in cash or bank balances. Trust companies must keep on hand a reserve of ten per cent. of their demand deposits (not including deposits of the City of Baltimore, secured by Baltimore City stock) in cash or in bank balances, and a further reserve of five per cent. of such deposits in bank balances or in United States, Maryland, or Maryland municipal securities.

North Carolina: Every bank and trust company must keep on hand a reserve of available funds (cash or balances due from solvent banks) equal to fifteen per cent. of all demand deposits and deposits payable within thirty days, and five per cent. on all postal savings deposits and deposits subject to withdrawal after not less than thirty days' notice. No reserve is required against deposits secured by North Carolina or United States bonds. State bank members are required to maintain only such reserves as are required by the Federal Reserve Act.

South Carolina: No reserve is required of state banks.

Virginia: Every bank and trust company must maintain a reserve of ten per cent. of its demand deposits and three per cent. of its time deposits.

West Virginia: All banking institutions are required to keep on hand a reserve of at least six per cent. of their demand deposits in lawful money, and an additional reserve of nine per cent. in lawful money or bank balances. State bank members are required to maintain only such reserves as are required by the Federal Reserve Act.

As a matter of course, a state bank becoming a member of the Federal Reserve System would be required, as a member bank, to carry the reserves specified in the Federal Reserve Act, whether the law of the state in which it was located required a reserve or not.

OBJECTIONS RAISED TO MEMBERSHIP.

117. What Are the Principal Objections Raised to Membership?

The principal objections raised to state bank membership are:

(1) THE LOSS *of interest on the reserve balance carried with the Federal reserve bank.*

(2) THE LOSS *of exchange, or rather the fact that non-member banks are able, in some cases, to charge exchange, while member banks are not.*

(3) THE IMPRESSION *that a great deal of "red tape" is involved in doing business with the Federal reserve bank.*

(4) THE FACT *that statements of customers are required in connection with paper offered for rediscount.*

(5) ADDITIONAL *expense and trouble due to explanations and reports.*

118. Why Is Interest Not Paid on the Reserve Balance Carried with the Federal Reserve Bank?

Because it is wrong in principle, and would defeat one of the most important objects for which the Federal Reserve System was established; namely, "to afford means of rediscounting commercial paper." If a Federal reserve bank were compelled to use at all times a large percentage of its resources to purchase paper in the open market for the purpose of earning interest to be paid to member banks on their reserve deposits, it is manifest that this would absorb its funds to such a degree as to leave itself without adequate resources to meet the needs of its member banks in case of sudden emergency or for heavy seasonal requirements.

Moreover, even if this were not the case, member banks would probably lose far more than they would gain if Federal reserve banks should pay them interest on their reserve deposits. The reserve deposits held by all Federal reserve banks amount to, approximately, $1,800,000,000. Interest at two per cent. on this amount would require the Federal reserve banks to keep invested at all times at least $900,000,000 at four per cent., and the competition which the necessary investment of this enormous sum would make inevitable would tend so to reduce the interest rates in the open market, under ordinary conditions, that the loss to member banks on all their loans would doubtless far exceed the income they would derive from the two per cent. interest on reserve deposits.

The Federal reserve banks are not intended to be money-making institutions, and anything that would force them to become money-making institutions would inevitably result in placing them in direct competition with their own member banks, not only in the matter of loans but also as competitors for bank balances. It is no more logical for a Federal reserve bank to pay interest on the reserve balance of a member bank than it would be for the member bank to pay itself interest on the cash in its own vaults.

119. Is It True That Banks Lose Money by Joining the Federal Reserve System Through Loss of Interest on the Idle Balance Carried with the Federal Reserve Bank?

The failure to collect such interest apparently results in a direct loss. This is much more than offset, however, by the fact that, having the benefit of a substantial and reliable reserve, which can be availed of in case of need, the member bank can afford to lend up its funds much more closely than would otherwise be practicable. Moreover, it can make contracts for certain lines of credit extending over a whole season with entire certainty of its ability to keep its contract, and, in the presence of an efficient reserve system, it can operate with less reserve than would be otherwise possible. It will be remembered that when the Federal reserve banks were first organized one of the earliest steps taken was to reduce materially the required reserves of all three classes of national banks.

120. How May a Member Bank Offset the Loss of Interest on Its Balance with the Federal Reserve Bank?

By studying the Federal Reserve System, acquainting itself with its possibilities, and availing itself of the services offered by the System. It is entirely possible for any bank, without serious inconvenience, so to readjust its methods of doing business that its connection with the Federal Reserve System will result in a substantial profit. This is not a theory, because the reports of the Comptroller of the Currency show that the profits of all national banks during the period in which the Federal Reserve System has existed have far exceeded the profits made during any previous period of similar length. This is in part due to growth, of course, but the growth under the Federal Reserve System has far exceeded the growth in any other period of banking history. Moreover, many state bank members have testified that their connection with the System has not only offset all apparent "losses," but has resulted in positive profit.

121. What Is Being Done with Reference to the Objection That Non-Member Banks May in Many Cases Continue to Charge Exchange on Checks Drawn on Themselves, While Member Banks Are Not Allowed to Make Such a Charge?

The par list of the Federal Reserve System is being gradually extended, and on June 30, 1920, it embraced 27,996 of the 30,153 banks in the United States. That the list will be further extended and will eventually embrace all solvent banks in the United States, is a foregone conclusion. For a further discussion of the par collection system of the Federal reserve banks see pages 48-55.

122. What Can Be Said in Reply to the Objection That "Red Tape" Is Involved in Dealing with the Federal Reserve Banks?

It is manifest that, since a Federal reserve bank acts under the law and the regulations of the Federal Reserve Board, it is necessary that member banks in dealing with it should be required to observe certain reasonable forms and to transact their business with a reasonable amount of regularity. These requirements are only irksome in the beginning, if at all; a very little practice makes every one of them a matter of course, and in a very short time the member bank becomes accustomed to transacting business in a uniform and regular manner and sees the great advantage of doing so, and is itself benefited thereby. It is only by observing a reasonable degree of uniformity that continual mistakes and misunderstandings can be avoided.

123. What Objection Is Oftenest Raised?

The objection oftenest raised by the new member bank is with respect to the information required in connection with paper offered for rediscount. In no case does the Federal reserve bank ever require information which the prudent banker would not, or should not, seek to have before making the loan to his customer, and in very many cases member banks have avoided serious losses by obtaining in advance of making loans the information which the Federal reserve bank would require of them if and when such notes are offered for rediscount

124. It Has Been Said That Rediscounting Is a Complicated and Time-Consuming Transaction. Is This True?

On the contrary, it is very simple. The member bank selects the paper from its portfolio, lists it upon a rediscount application sheet furnished by the Federal reserve bank, and sends the sheet and the paper, accompanied, when necessary, by copies of the statements of borrowers on file with the bank. Upon receipt and acceptance of the offering, the Federal reserve bank gives credit for the proceeds upon the same day with advice to the member bank. On the back of the rediscount application sheet are printed simple but complete directions for the selection of paper eligible for rediscount, and the sheet itself clearly indicates how the paper is to be listed and what information is to be given with respect to each note.

125. Are the Objections Raised on the Ground of Additional Expense and Trouble Due to Examinations and Reports Well Founded?

It is believed that they are not. It is the testimony of state bank members that, while some slight trouble and expense are incurred in making reports, particularly where the accounting system of the member bank is incomplete or imperfect, the advantage to the member bank itself of compiling in succinct form the information asked for in the report far outweighs the trouble and expense of securing it. State bank members have the peculiar advantage of enjoying the benefits of the Federal Reserve System while retaining all the privileges granted to them by their charters or the laws of their states, except such privileges as may be in direct conflict with the express terms of the Federal Reserve Act.

ADVANTAGES OF MEMBERSHIP.

126. What Advantages Are Afforded a State Bank by Membership in the Federal Reserve System?

The advantages offered are of two kinds.

The first are general in nature, and arise from being a part of a strong banking system, which strengthens the whole financial, industrial, and commercial situation of the country. The member bank is greatly strengthened by the support of the System, and the public is quick to appreciate the added security. Since such a system can reach its highest efficiency only when it embraces all commercial banking institutions, the addition of any institution to its membership necessarily gives it additional strength.

The second are the special benefits that accrue from membership, among which are:

(1) INCREASED *security.*

(2) GREATER *ability of a member bank to grant accommodation to its customers.*

(3) INCREASED *ability to obtain rediscounts.*

(4) EASY *transfer of funds by draft or telegraph.*

(5) SHIPMENTS *of currency without cost.*

(6) PARTICIPATION *in the free check collection service of the Federal Reserve System.*

127. How Is Increased Security Afforded by Membership?

Through its own large reserves and through the power to discount with all other Federal reserve banks, combined with the power of issuing Federal reserve notes, a Federal reserve bank can come to the assistance of every well-managed member bank in time of need. This additional security reaches (a) to the borrowers of the member bank, because they can count with certainty on reasonable lines of credit for agricultural, industrial, and commercial needs; (b) to the depositors, because they can count upon the repayment to them of their deposits by the member bank, through the greater ability of the member bank to rediscount eligible paper with the Federal reserve bank; and (c) to the stockholders, because it strengthens the bank and insures the ability to maintain its business relations with depositors and borrowers without the many checks and interruptions incident to the operation of the old National Banking System. Viewed solely as insurance, membership in the Federal Reserve System affords protection and the means of growth which could not be purchased by any reasonable annual premium, and we are convinced that, in time, no non-member will be able to compete for and solicit the business of the public on equal terms with member banks.

128. How Is the Banking and Financial System Strengthened by the Admission of State Banks?

Through the concentration of reserves, which may be likened to a wire cable each strand of which, taken alone, is weak, but in combination can sustain an enormous strain. The reserve of each bank is in itself relatively weak, but, in combination with the reserves of other members of the Federal reserve bank, can resist the shock of financial panic.

129. How Does the Reserve Principle of the Federal Reserve Banks Differ from That of the Old National Banking System and the State Bank Systems?

Under the old national banking law, national banks' reserves were carried as "cash in vault" and "deposits with banks in reserve or central reserve cities." Such deposited reserves were loaned in large part, and, in time of panics such as those that occurred in 1893, 1902, and 1907, these reserve agents were in no position to pay the reserves deposited with them without calling their loans to such an extent as to add materially to the difficulties of the situation. This redepositing and pyramiding of reserves was one of the recognized evils which the Federal Reserve Act has obviated in so far as member banks in the Federal Reserve System are concerned. Through the mobilization of the reserves of its members and its power of note issue, the Federal reserve bank is able to convert eligible paper of members into currency or credit, either of which is available to the member bank on demand.

130. How Does the Principle of Central Reserves Give Greater Safety to Member Banks?

By the principle of concentrating the reserves of all the member banks of a district in one Federal reserve bank, and of further centralizing the reserves of the whole country by a system of rediscounting between Federal reserve banks, the surplus reserve in one part of the country is available for use in another part. Since the seasonal demands vary as to time in different localities, it is always possible to obtain needed funds in one locality by drawing upon temporarily idle reserves in another locality.

131. Is It Necessary for a Country Member Bank to Carry a Secondary Reserve in the Shape of Bank Balances?

No. If it has in its possession a sufficient amount of paper eligible for rediscount, this in itself constitutes a secondary reserve; and every well-managed bank always has, or normally has, enough of such paper to enable it to meet all sudden demands by rediscounting it with its Federal reserve bank. The interest or discount on such eligible paper is always larger than the interest received on balances maintained with other banks.

132. How Does Membership Enable a Bank to Extend Additional Accommodation to Its Customers?

The ability to replenish reserves through rediscount is a guarantee of ability to meet the requirements of customers. Well-managed member banks, therefore, even when loaned up as to their own resources, will still be able to count upon obtaining funds by rediscount to meet further unexpected and urgent demands. The rediscount provisions of the Federal Reserve Act were established to afford guarantees that member banks will be able at all times to care for the reasonable and legitimate necessities of their customers. As long, therefore, as a member bank does not undertake to transact a business out of proportion to its working capital and does not tie up its resources in speculative transactions or capital loans, it can be certain of being able to take care of the seasonal requirements of its customers.

133. Is It True That the Smaller Banks Have Little, if Any, Paper Eligible for Rediscount?

Many bank officers are under the impression that their banks have no paper eligible for rediscount with a Federal reserve bank, when such is by no means the case. Any paper made by a solvent person, firm, or corporation, the proceeds of which have been used, or are to be used, for a current industrial, commercial, or agricultural operation, is eligible for rediscount. As a matter of course, the amount which can be loaned to any one borrower will depend upon his ability to repay, as is indicated by a comparison between what he owns and what he owes. This information, however, is no more than any prudent banker should require in any case.

134. Are Notes for Small Amounts Eligible?

Yes. The amount of a note does not affect its eligibility. As a matter of fact many of the small country banks frequently discount notes for $25 or less. It is manifest, however, that in offering paper to a Federal reserve bank, a member bank will naturally select notes of reasonable size in order to save itself the trouble of listing a large number of items on its application sheet. The Federal Reserve Bank of Richmond, however, has never, on account of its smallness, rejected any note offered to it for rediscount.

135. Of What Advantage to Member Banks Are the Transfer and Collection Services of Their Federal Reserve Banks?

The Federal reserve banks have placed at the disposal of member banks facilities never before approached in this country. By the transfer service, funds can be made immediately available in any part of the country. Transfers in any amount are made by wire for the credit of the member bank with any member bank in any other Federal reserve district. This service is without cost to the member bank.

By a more direct routing and check collection than was possible under the old system, the saving in time is very considerable, and the aggregate float, the collecting cost of which has always been borne in one way or another by the banks of the country, has been practically cut in half.

136. Are the Country Banks at a Disadvantage as Compared to the Banks in Cities Where the Federal Reserve Bank or a Branch Is Located?

To a certain extent a bank located in a Federal reserve or branch city enjoys some advantages. It is able to operate with less vault cash. It can start its collection items through the channels of the Federal Reserve System more promptly and it can act more promptly in restoring its reserve by immediately lodging paper for rediscount with the Federal reserve bank or branch. On the other hand, it must pay checks drawn upon itself one or two days sooner than banks located in other places. The Federal Reserve Bank of Richmond has attempted to minimize the disadvantages borne by the banks in other cities by bearing the cost of telegraphic messages directing transfers to other Federal reserve districts and ordering the shipment of currency to member banks. It also bears the cost on currency to and from the member bank, provided the member bank observes the regulations covering such shipments (see our Circular No. 84).

137. Do Not the Banks Located in Reserve and Branch Cities Enjoy Exceptional Advantages Arising from Their Ability to Secure the Accounts of Other Banks Who Are Members of the Federal Reserve System, or Who Have Occasion to Remit to the Federal Reserve Bank or Branch of the District in Which They Are Located?

Banks located in Federal reserve and branch cities formerly had a decided advantage with respect to such accounts, and must always of necessity continue to possess some advantages. All banks in the Fifth Federal Reserve District, however, have been placed, as far as possible, on an equality in this respect by the introduction and development of the Immediate Credit Symbol system. For further particulars with respect to the use of the Immediate Credit Symbol see our Circular No. 93 and Questions Nos. 99-101 on pages 57-59.

138. Is There Any Advertising Value in Membership in the Federal Reserve System?

There is unquestionably a very substantial advertising value in membership in the Federal Reserve System. Member banks have found that membership increases their prestige and attracts business. The confidence of the public at large in the Federal Reserve System is well-nigh boundless. It may be confidently stated as a fact that the state banks (and banks generally, of course) have received more advantage from the Federal Reserve System, arising out of the following single circumstance, than they have received from all other sources combined. During the trying period through which this country passed, it was the supreme confidence of the people in the ability of the Federal Reserve Banking System to function properly that induced millions of depositors to leave their money in the banks of the country (non-member as well as member) instead of checking it out for hoarding purposes, as was so frequently done in time of trouble or anticipation of trouble on former occasions. The Federal Reserve System has justified this confidence, and money flowed into the banks instead of out of them, and their deposits increased as never before. But the time is before us, in which the demands of depositors (who are also borrowers) on their institutions will be specific, rather than general. They are already asking whether the institutions with which they are banking are members of the Federal Reserve System or not, and they will ask this question more and more.

VIII. Sundry Provisions

CLAYTON ANTI-TRUST ACT.

139. What Is the Clayton Anti-Trust Act?

The Clayton Anti-Trust Act, approved October 15, 1914, provides:

> (1) THAT *no person shall at the same time be a director or other officer or employee of more than one bank, banking association, or trust company organized or operating under the laws of the United States either of which has deposits, capital, surplus, and undivided profits aggregating more than* $5,000,000.
>
> (2) THAT *no private banker or person who is a director in any bank or trust company organized and operating under the laws of a state having deposits, capital, surplus, and undivided profits aggregating more than* $5,000,000, *shall be eligible to be a director in any bank or banking association organized or operating under the laws of the United States.*
>
> (3) THAT *no bank, banking association, or trust company organized or operating under the laws of the United States, in any place having more than* 200,000 *inhabitants, shall have as a director or other officer or employee any private banker or any director or other officer or employee of any other bank, banking association, or trust company located in the same place.*

The above provisions do not apply to mutual savings banks not having a capital stock represented by shares, and do not prohibit a person from being at the same time a Class A director of a Federal reserve bank and also an officer or director, or both, in one member bank;

or from being an officer, director, or employee of one member bank and one other bank, where the entire capital stock of the second is owned by the stockholders of the first.

On May 15, 1916, Congress amended Section 8 of the Clayton Act, and provided that nothing in the Act shall prohibit any officer, director, or employee of any member bank, or Class A director of a Federal reserve bank, from being an officer, director, or employee of not more than two other banks, if the permission of the Federal Reserve Board is first applied for and if such other banks are not in substantial competition with the member bank.

140. Does the Clayton Anti-Trust Act Affect State Bank Members in the Federal Reserve System?

In an opinion dated September 10, 1917, the Attorney General of the United States held that the application of the provisions of the Clayton Act to a state bank was not affected by the fact that such bank was a member of the Federal Reserve System.

FIDUCIARY POWERS.

141. What Are Fiduciary Powers?

Under Section 11(k) of the Federal Reserve Act, the Federal Reserve Board is authorized and empowered "To grant by special permit to national banks applying therefor, when not in contravention of state or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which state banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the state in which the national bank is located."

These powers are granted after application upon a form provided by the Federal Reserve Agent, which application is forwarded to the Federal Reserve Board with his recommendation. Applications are granted by the Federal Reserve Board and official notice is forwarded to the applying bank.

142. Are State Bank Members Authorized to Exercise Fiduciary Powers?

No. The Federal Reserve Act makes no mention of state bank members in authorizing the Federal Reserve Board to grant these powers. The Board is permitted to grant them only to national banks. State banks are under the control of the laws of the state under which they are chartered, but member state banks may exercise such powers if authorized by their charters or by the law of the state to do so (see Question No. 105).

POSTAL SAVINGS DEPOSITS.

143. What Is the Effect of Membership in the Federal Reserve System upon a Bank's Right to Obtain Postal Savings Deposits?

The law now provides that new or additional postal savings shall be deposited with member banks only, and state bank and trust company members are entitled to receive postal savings deposits on a par with national banks, according to the plan of distribution of such deposits.

144. What Is the Federal Reserve Bulletin?

The Federal Reserve Board publishes on the first of each month the *Federal Reserve Bulletin*, which is its official digest of financial topics of interest to member banks, and which contains complete data and information in regard to current affairs ot the Federal Reserve System, together with the rulings of the legal department of the Federal Reserve Board from time to time, and the regulations and informal rulings of the Board.

The *Federal Reserve Bulletin* is the Board's medium ot communication with member banks of the Federal Reserve System and is the only official organ or periodical publication of the Board. It is printed in two editions, of which the first contains the regular official announcements, the national review of business conditions, and other general matter, and is distributed without charge to the member banks of the Federal Reserve System. The second edition contains detailed analyses of business conditions, special articles, review of foreign banking, and complete statistics showing the condition of Federal reserve banks. For this second edition the Board has fixed a subscription price of $4 per annum to cover the cost of paper and printing. Single copies will be sold at 40 cents. Foreign postage should be added when it will be required. Remittances should be made to the Federal Reserve Board.

Member banks desiring to have the *Bulletin* supplied to their officers and directors may have it sent to not less than 10 names at a subscription price of $2 per annum.

No complete sets of the *Bulletin* for 1915, 1916, or 1917 are available.

REGULATIONS OF FEDERAL RESERVE BOARD.

145. How Are the Regulations of the Federal Reserve Board Issued?

In pamphlet form. The general and special regulations are obtainable on application to any Federal reserve bank.

REGULATIONS OF THE FEDERAL RESERVE BANK OF RICHMOND.

146. How Are the Regulations of the Federal Reserve Bank of Richmond Issued?

In circular form. These regulations and circulars embody all information and data a member bank should have. Complete sets of current regulations are furnished to state banks as soon as they become members.

Appendix

FORM SHOWING METHOD OF COMPUTING RESERVE TO BE CARRIED WITH THE FEDERAL RESERVE BANK BY MEMBER BANKS

DEMAND DEPOSITS

1. Deposits, other than United States Government deposits, payable within thirty days			
2. Balances due to banks, other than Federal Reserve Banks	$		
*3. Deferred Credits due Federal Reserve Bank	$		
4. Cashier's Checks on own Bank outstanding	$		
5. Certified Checks outstanding	$		
TOTAL DUE TO BANKS (Items 2, 3, 4 and 5)		$	
Less:			
6. Balance due from banks, other than Federal Reserve Bank	$		
*7. Items with Federal Reserve Bank in process of collection	$		
8. Checks on other banks in same place	$		
9. Exchanges for clearing house	$		
TOTAL DEDUCTIONS (Items 6, 7, 8 and 9)		$	
10. Net Balance due to banks**			$
11. TOTAL DEMAND DEPOSITS (Items 1 and 10)			$

TIME DEPOSITS

12. Savings accounts (subject to not less than thirty days' notice before payment)	$	
13. Certificates of deposit (subject to not less than thirty days' notice before payment)	$	
14. Other deposits payable only after thirty days	$	
15. Postal Savings deposits	$	
16. TOTAL TIME DEPOSITS (Items 12, 13, 14 and 15)		$

RESERVE REQUIRED

Banks in Reserve Cities, 10 per cent.; elsewhere, 7 per cent. of Demand deposits (Item 11)	$	
Three per cent. of Time deposits (Item 16)	$	
Total reserve to be maintained with Federal Reserve Bank		$

*If only one Deferred Account is carried with the Federal Reserve Bank, the credit balance must be shown under Item No. 3 or the debit balance under Item No. 7.

**Should the aggregate "due from banks" (Items 6, 7, 8 and 9) exceed the aggregate "due to banks" (Items 2, 3, 4 and 5), both items must be omitted from the calculation.

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(Figures refer to the numbered questions the answers to which treat the topics indicated.)

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