PENALTIES FOR DEFICIENCIES IN MEMBER BANKS' RESERVES

TO THE MEMBER BANKS OF DISTRICT NUMBER SEVEN:

In accordance with a ruling of the Federal Reserve Board, effective October 1, 1919, penalties for deficiencies in reserves will be assessed basis the weekly average balance carried on our books in the case of member banks located in central reserve and reserve cities, and for member banks located outside of central reserve and reserve cities, penalties will be assessed basis the semi-monthly average balance.

Section 19 of the Federal Reserve Act, after specifying the reserve requirements for member banks, provides that:

"The reserve balance carried by a member bank with a Federal reserve bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities: Provided, however, That no bank shall at any time make new loans or shall pay any dividends unless and until the total reserve required by law is fully restored."

Regulation J. (Series of 1917) of the Federal Reserve Board, which prescribes the penalty, reads in part as follows:

"Inasmuch as it is essential that the law in respect to maintenance by member banks of the required minimum reserve shall be strictly complied with, the Federal Reserve Board, under authority vested in it by Section 19 of the Act, hereby prescribes as the penalty for any deficiency in reserves a sum equivalent to an interest charge on the amount of the deficiency of 2 percent per annum above the ninety day discount rate of the Federal Reserve Bank of the district in which the member bank is located. The Board reserves the right to increase this penalty whenever conditions require it."

The foregoing indicates clearly that the imposition of a penalty for deficient reserves is not an arbitrary action on the part of the Federal Reserve Bank, but is expressly provided for in the Federal Reserve Act itself.

For the present the penalty, based on the above ruling, is at the rate of 6¾ percent per annum.

This will not occasion any change in the present practice of reporting to us net deposits and required reserve.

Respectfully,

JAMES B. McDOUGAL
Governor