

FEDERAL RESERVE BANK OF DALLAS

November 29, 1918.

TO ALL MEMBER BANKS OF THE ELEVENTH DISTRICT:

Your attention and careful study of the accompanying letter from the Governor of the Federal Reserve Board to the Chairman of this bank is invited. Without unduly hampering any legitimate industry, the duty and demand of the hour should constrain and lead all the banks to a careful husbanding of their resources, the wisest possible conservation of credits and as considerable a liquidation as may be reasonably practicable.

Respectfully,
FEDERAL RESERVE BANK OF DALLAS.

FEDERAL RESERVE BOARD
WASHINGTON

SUBJECT: EXCESSIVE REDISCOUNTS BY MEMBER BANKS.

November 19, 1918.

MR. W. F. RAMSEY, Chairman,
Federal Reserve Bank of Dallas.

Dear Sir: The attention of the Federal Reserve Board has been called to the fact that in some instances member banks have applied for and obtained rediscounts which appear to be largely in excess of their actual needs or the requirements of the community served, and that they have used the proceeds of these rediscounts to purchase paper in the open market or to make loans to non-member banks at a substantial profit to themselves.

The Board does not, of course, desire in any way to discourage the proper commercial activities of member banks nor to criticise the very natural desire of bank officers to increase the normal profits and business of their institutions. The Board deems it its duty, however, to caution the bankers, who have rendered and are rendering such efficient service to the Government in the present circumstances, that profit making and business expansion must, for some time to come, continue to be subordinated to the general welfare. There is no assurance that the cessation of hostilities in Europe will be followed by a reduction in demands made upon our banking resources.

Our credit resources must, therefore, be conserved and used to meet the actual requirements of the country at large, and when the needs of a given community have been supplied, there should be no diversion of resources from other sections merely to increase the profits or the business of the banks in that community.

Rediscounting operations between Federal Reserve Banks are essential in many cases and are being freely engaged in. They are made necessary by the Government's operations and by the seasonal requirements of the various Federal Reserve districts, but they ought not to be engaged in merely for the benefit of member banks of any particular Federal Reserve district as a means of enabling them to go outside of their natural field of activity to attract business or to make profits. A member bank which has received from its Federal Reserve Bank accommodations sufficient for meeting its legitimate local demands should not be permitted to secure additional accommodation merely for the purpose of increasing its profits or expanding its business beyond reasonable limits.

A non-member bank which has contributed none of its resources to the Federal Reserve system ought not to be permitted to use a member bank as a medium or agency for the purpose of procuring accommodations from Federal Reserve banks, unless upon presentation of the facts to the Federal Reserve Board such a course is found to be necessary or advisable in the public interest.

The duty is expressly imposed upon the directors of Federal Reserve banks in extending accommodations to member banks to consider at all times the possible actual needs of all of their member banks. Section 4 of the Federal Reserve Act contains a specific provision that the directors of the Federal Reserve Bank "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."

Having knowledge of the fact that abnormal demands must be expected to continue, the directors of the Federal Reserve Banks should exercise a reasonable prudence in extending accommodations to any member bank, and should be satisfied, by proper inquiry or investigation, that the accommodation sought is for legitimate local requirements and not applied for merely for the purpose of increasing the profits or expanding the business of the borrowing bank. While the directors, with the approval of the Federal Reserve Board, might, by advancing the discount rates, curtail the credits extended to banks seeking rediscounts for the sole purpose of profit-making, such a course might work a hardship upon other member banks seeking rediscounts for their actual needs and might result in an enforced and premature liquidation of legitimate credits.

Section 21 of the Federal Reserve Act provides in part that:

"Every Federal Reserve Bank may, with the approval of the Federal Reserve agent or the Federal Reserve Board, provide for special examination of member banks within its district. The expense of such examinations shall be borne by the bank examined. Such examinations shall be so conducted as to inform the Federal Reserve Bank of the condition of its member banks and of the lines of credit which are being extended by them."

While it is not desired that member banks should be required to incur any unnecessary expense in the matter of examinations, the Board suggests that in those cases in which member banks are borrowing greater amounts than appear to be justified by the actual needs of the bank, before such lines are further extended the member bank should be required to make a full disclosure of the lines of credit which it is extending, whether or not it is using the funds obtained from the Federal Reserve Bank to purchase paper in the open market merely to increase the profits of the bank, and particularly whether it is being used by non-member banks, without the permission of the Federal Reserve Board, as a medium or agency for obtaining accommodations from the Federal Reserve Bank.

When deemed necessary, an assistant Federal Reserve agent or a representative of the Federal Reserve Bank might call personally upon the officers of the member banks whose rediscounts with the Federal Reserve Bank are out of proportion to their capital and surplus in order that the situation may be fully discussed and understood. In case any member bank should fail or refuse to furnish the Federal Reserve Bank with full information regarding its lines of credit, an examination should be made by the Federal Reserve Bank of its affairs and the facts reported to the Federal Reserve Board for such action as may be found to be necessary.

Very truly yours,
W. P. G. HARDING,
Governor.