



FEDERAL RESERVE BANK
OF DALLAS

April 18, 1919.

VALUABLE INFORMATION REGARDING RESERVE AND PENALTY CHARGES

To the Member Banks of District No. 11:

It is believed that some of our member banks are subjecting themselves to **unnecessary** penalty charges, on account of their failure to maintain their legal reserve, either through the lack of a clear understanding of the method and principles involved, or through carelessness and inattention to the matter on the part of their employees.

Not only have we found both of these assumptions to be correct in analyzing the underlying course of recurring deficiencies, but frequently it has developed that **proper attention has not been given to this most important subject by the bank's executive officers.**

The penalty charge for deficient reserve is based upon an amount equal to 2% above the present ninety-day discount rate, or on a basis of 7%, with an increase of 1% for each successive deficiency after the third week. This penalty charge is **not** for the purpose of creating revenue for the Federal Reserve Bank, and the necessity for its assessment is invariably a matter of regret to us, particularly in view of the fact that a method has been provided whereby it may be avoided; namely, by use of our rediscount facilities as outlined in Circular No. 29, Series 1918.

It should undoubtedly be the desire of each member bank of our District to comply fully, at all times, with the requirements covering the maintenance of the legal reserve, and it is our earnest desire that they do so.

With the facilities provided for their use in this connection always available, under proper restrictions; with the Federal Reserve Bank and its officials ready to extend all aid consistent with a proper interpretation of the terms of the Federal Reserve Act, and with the payment of interest on paper rediscounted for the restoration of impaired reserves always less expensive than the payment of penalty charges, it is difficult for us to see why a member bank should ever be deficient unless through clerical error, or because of lack of proper official attention.

The purpose of the reserve requirements of member banks, as set forth in Section 19 of the Federal Reserve Act, is to create a basis for the expansion of credit through currency issue. In order that all banks may derive the benefit of this credit, it is absolutely necessary that each maintain the reserve upon which this credit is founded. It is obviously necessary, therefore, that penalties for deficiencies be impartially enforced. The reserve requirements are part of the Federal Reserve Act, and not an arbitrary rule of this bank, and the officers of the Federal Reserve Bank of Dallas have no option but their enforcement when deficiencies occur.

We shall appreciate the courtesy of your co-operation in line with the above.

Respectfully,

A handwritten signature in cursive script, reading "R. L. Van Zandt".

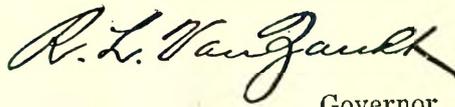
Governor.

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, without regard to the amount the borrowing bank may have already loaned to its borrower under his regular line of credit; provided, however, that the aggregate of all rediscounts must in no case exceed twenty per centum of the capital and surplus of the member bank.

ILLUSTRATION: The result in a specific case would be as follows: State member bank A has loaned 15% to X on his regular line of credit and 15% to X on the security of Government obligations of the kinds specified. What and how much might the Reserve Bank rediscount of these items? The regular line being in excess of 10%, Section 9 applies **none** of that paper may be rediscounted by the amendment of March 3, 1919, authorizes the rediscount of paper in "excess" of what could have been rediscounted heretofore under Section 9, provided first that the excess be secured by Government obligations of the kinds specified and provided; second, that the aggregate in no event shall exceed 20%. In the case supposed therefore, the Reserve Bank could take all 15% of the paper secured by the Government obligations but none of the paper taken in X's regular line of credit. If the commercial line had been 9%, for instance, the Reserve Bank could rediscount all of the 9% and in addition 11% of the paper secured by Government obligations, making a total of 20% of the capital and surplus of the member bank."

Rediscounts of paper secured by Government obligations will be handled in accordance with the foregoing.

Yours very truly,

A handwritten signature in cursive script, reading "R. L. Van Zandt". The signature is written in dark ink and is positioned above the printed name "Governor.".

Governor.