

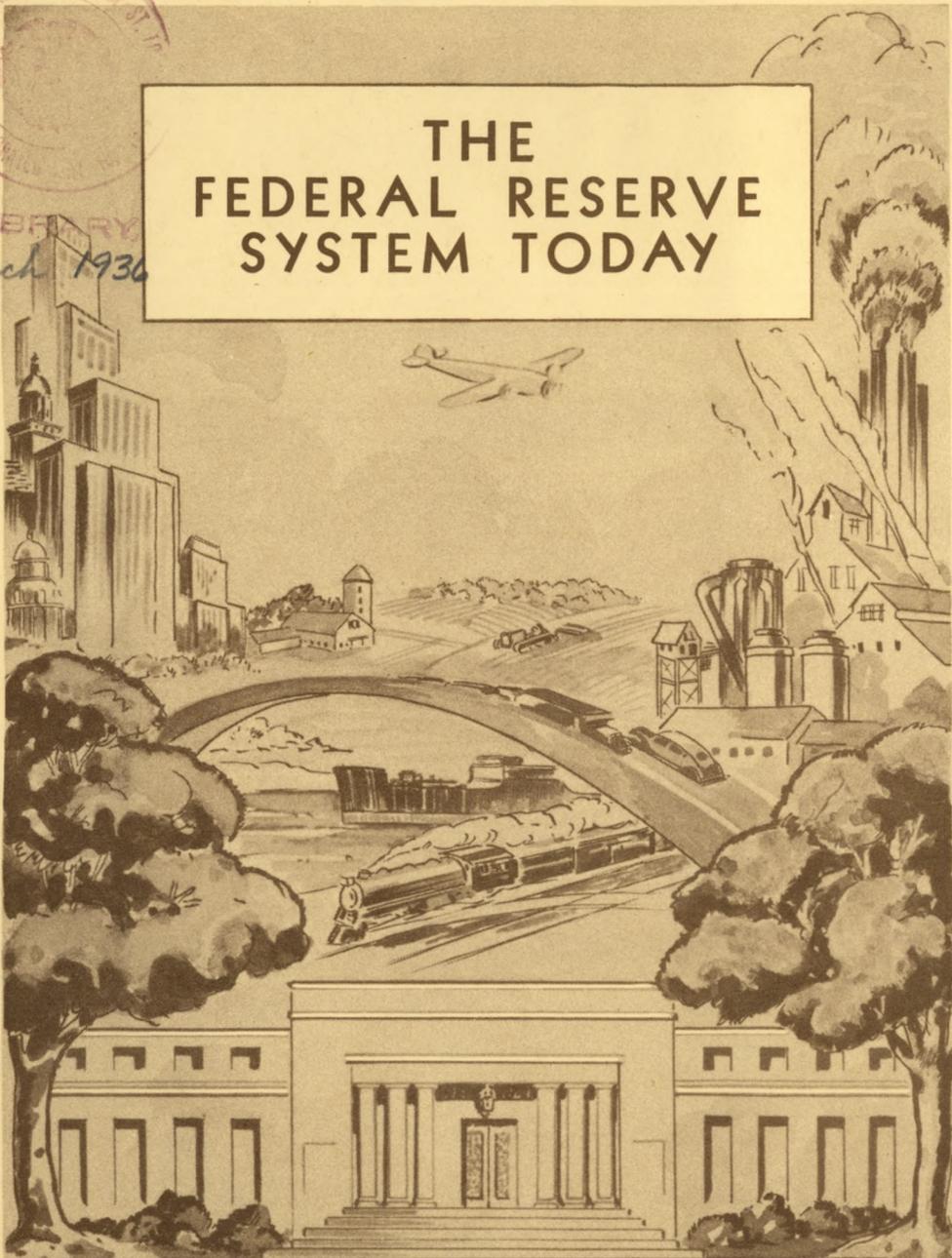
Federal Reserve Bank of St. Louis [1936]

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THE FEDERAL RESERVE SYSTEM TODAY



**FINANCE - AGRICULTURE
INDUSTRY - COMMERCE**

THE
FEDERAL RESERVE SYSTEM
TODAY



Federal Reserve Bank of St. Louis
March, 1936



*Architect's Drawing of New Building of the Board of Governors
of the Federal Reserve System, Washington, D. C.*

FOREWORD

This booklet was prepared under the auspices of the Federal Reserve Agents' Conference primarily to give the essential facts regarding the System itself, and to furnish banks with a general outline of the requirements for membership.

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THE FEDERAL RESERVE SYSTEM TODAY

The Federal Reserve System was created by the Federal Reserve Act, approved December 23, 1913. The twelve Reserve banks opened their doors for business on November 16, 1914.

Coming into existence within a few months after the outbreak of the World War, the System has been faced throughout its history with problems of operation and of policy arising from abnormal economic and financial conditions throughout the world. In surmounting resultant difficulties and notably in helping the Government to finance its participation in the World War, the System met successive tests of its strength and soundness. Both in the period of rapid expansion during the war and in the subsequent contraction during the post-war depression of 1920 and 1921, the System's adaptability to changing conditions and its capacity for meeting demands upon its resources were put to a severe test.

In the succeeding eight years, the System was confronted with changed but no less difficult conditions. A steady flow of gold from abroad furnished a basis for a vast expansion of credit which was sufficient not only to meet all legitimate needs of trade, but also to finance speculative activity in the securities markets, in real estate, and in other fields. The collapse of this speculative boom was followed by a period of world-wide business and industrial stagnation of unprecedented severity, culminating in the almost complete paralysis of this country's banking machinery. During the depression, the System cushioned the decline by an easy money policy and, upon the reopening of the banks after the proclamation of the national banking holiday, the System actively cooperated in the rehabilitation of the banking structure and in the restoration of economic and financial confidence.

Experience gained during two decades of the System's operations afforded a valuable basis for further adapting its functions

and administration to serve the public interest. With the passage of the Banking Act of 1935, the System's responsibilities were broadened and more clearly defined and allocated. The act embodied numerous changes, some of which were fundamental in character, reflecting a broader conception of the System's place in the nation's economic life than existed when it was established. Machinery for the formulation and execution of open-market policies was simplified and responsibility for open-market operations, as well as for discount rates and reserve requirements, was clearly fixed with a view to enlarging the System's ability to maintain sound credit conditions and to serve the needs of trade and industry.

THE FEDERAL RESERVE SYSTEM TODAY

The Federal Reserve System comprises several parts, including:

1. The Board of Governors of the Federal Reserve System.
2. The Federal Open Market Committee.
3. Twelve Federal Reserve banks with 25 branches.
4. Member banks, numbering about 6,500.
5. Federal Advisory Council.

Board of Governors of the Federal Reserve System—Broad supervisory powers are vested in the Board of Governors of the Federal Reserve System which has its offices in Washington. The Board of Governors is composed of seven members appointed by the President with the advice and consent of the Senate. In selecting these seven members, the President is required to have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country. No two members may be from the same Federal Reserve district.

Among the many responsibilities of the Board of Governors, those concerning the credit policies of the System are the most important. The discount rates charged by the Reserve banks, which are established by the boards of directors of these banks, are subject to the review and determination of the Board of Governors. The Board may, within certain limitations and in order to prevent injurious credit expansion or contraction,

change the requirements as to reserves to be maintained by member banks against deposits. After March 1, 1936, each member of the Board of Governors will also be a member of the Federal Open Market Committee, which is charged with the responsibility of determining policy in connection with purchases and sales of bills and securities in the open market—an operation which is discussed more fully in a later paragraph. Actions along these lines must be taken with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country.

For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Board of Governors is authorized to regulate the amount of credit that may be initially extended and subsequently maintained by brokers, banks, and others on any security (with certain exceptions) registered on a national securities exchange. Certain other powers have been conferred upon the Board which are likewise designed to enable it to prevent an undue diversion of funds into speculative operations.

In connection with its supervision of Federal Reserve banks, the Board of Governors is also authorized to make examinations of such banks; to require statements and reports from them; to require the establishment or discontinuance of their branches; to supervise the issue and retirement of Federal Reserve notes; and to appoint some of the directors of each Reserve bank and to approve the appointment of the chief executive officers, as described in later paragraphs.

In connection with its supervision of member banks, the Board is authorized among other things (1) to pass on the admission of State banks and trust companies to membership in the Federal Reserve System and on the termination of membership of such banks; (2) to examine member banks and receive condition reports from State member banks and their affiliates; (3) to limit by regulation the rate of interest which may be paid by member banks on time and savings deposits; (4) to issue voting permits to holding company affiliates of member banks entitling them to vote the stock of such banks at any or all meetings of shareholders of the member banks; (5) to regulate interlocking relationships between member banks and organizations dealing in securities or, under the Clayton Antitrust Act, between member banks and other banks; (6) to remove officers and directors of a member bank for con-

tinued violations of law or unsafe or unsound practices in conducting the business of such bank; (7) to suspend member banks from the use of the credit facilities of the Federal Reserve System for making undue use of bank credit for speculative purposes or for any other purpose inconsistent with the maintenance of sound credit conditions; (8) to pass on applications of State member banks to establish out-of-town branches; (9) to pass on applications of national banks for authority to exercise trust powers or to act in fiduciary capacities; (10) to grant authority to national banks to establish branches in foreign countries or dependencies or insular possessions of the United States, or to invest in the stock of banks or corporations engaged in international or foreign banking; (11) to supervise the organization and activities of corporations organized under Federal law to engage in international or foreign banking. In exercising its supervisory functions over the Federal Reserve banks and member banks, the Board of Governors promulgates regulations governing certain of the activities of Federal Reserve banks and member banks.

To meet its expenses and to pay the salaries of its members and its employees, the Board makes semi-annual assessments upon the Federal Reserve banks in proportion to their capital stock and surplus.

The Board of Governors is required under the Banking Act of 1935 to keep a complete record of its actions on all questions of policy together with the votes taken and the reasons underlying such actions, and to include this record in its annual report to Congress.

Federal Open Market Committee—Federal Reserve banks are authorized to buy and sell in the open market bonds and short-term obligations of the United States, bankers' acceptances, and other assets listed in a later paragraph. Such purchases and sales may only be made in accordance with the direction and regulation of the Federal Open Market Committee.

Effective March 1, 1936, the Federal Open Market Committee consists of the seven members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve banks who are to be elected annually. One member is elected by the boards of directors of the Federal

Reserve Banks of Boston and New York, one by the Federal Reserve Banks of Philadelphia and Cleveland, one by the Federal Reserve Banks of Chicago and St. Louis, one by the Federal Reserve Banks of Richmond, Atlanta, and Dallas, and one by the Federal Reserve Banks of Minneapolis, Kansas City, and San Francisco.

Decisions in regard to open-market purchases and sales are made with reference to general credit conditions. When there is evidence of undue use of bank credit, or indications of heavy speculative demands for credit that are tending to create unsound conditions, the Reserve banks, under the direction of and regulations adopted by the Federal Open Market Committee, may sell securities in the open market, payment for which results in a reduction in the reserve deposits of member banks in their Federal Reserve bank. In order to prevent injurious credit expansion, the Board of Governors may also, with certain limitations, increase reserve requirements. The sale of securities in the open market or the increase of reserve requirements would normally have the effect of requiring member banks either to curtail their own operations or borrow from the Reserve banks. The Federal Reserve banks may exert further pressure on borrowing banks by raising discount rates, with the approval of the Board of Governors, making it more expensive for member banks to borrow.

On the other hand, when business is receding and credit demand is low, the Reserve banks, under the direction and regulations of the Open Market Committee, may buy securities in the open market and thereby increase the reserve deposits of member banks, thus enabling them to make additional loans or investments without having to borrow from the Reserve banks. Open-market operations, therefore, exert an important influence on the volume of credit available to business and investors and on interest rates, that is, on the cost of this credit.

Under the Banking Act of 1935, a complete record is kept of the actions taken by the Federal Open Market Committee upon questions of policy, together with the votes taken and the reasons underlying the Committee's actions. This record will be published in the Annual Report of the Board of Governors of the Federal Reserve System.

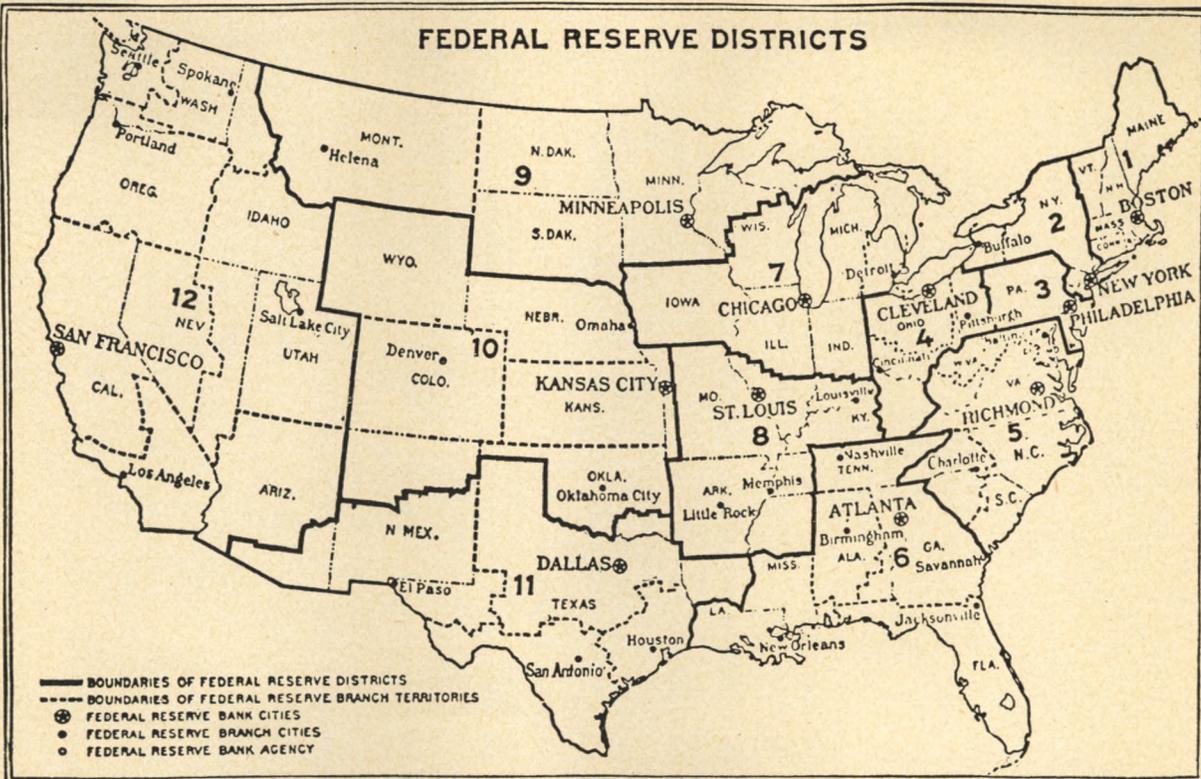
The Federal Reserve Banks—The country is divided into twelve Federal Reserve districts, in each of which there is a Federal Reserve bank bearing the name of the city of its location. There are also in operation 25 branches of Federal Reserve banks and 2 agencies, as listed below:

District Number	Location of Federal Reserve Bank	Location of Branch
1.....	Boston.....	
2.....	New York.....	Buffalo, New York
3.....	Philadelphia.....	
4.....	Cleveland.....	Cincinnati, Ohio Pittsburgh, Penna.
5.....	Richmond.....	Baltimore, Maryland Charlotte, N. C.
6.....	Atlanta*.....	Birmingham, Alabama Jacksonville, Florida Nashville, Tennessee New Orleans, Louisiana
7.....	Chicago.....	Detroit, Michigan
8.....	St. Louis.....	Little Rock, Arkansas Louisville, Kentucky Memphis, Tennessee
9.....	Minneapolis.....	Helena, Montana
10.....	Kansas City.....	Denver, Colorado Oklahoma City, Okla. Omaha, Nebraska
11.....	Dallas.....	El Paso, Texas Houston, Texas San Antonio, Texas
12.....	San Francisco.....	Los Angeles, California Portland, Oregon Salt Lake City, Utah Seattle, Washington Spokane, Washington

* In addition to the branches named, the Federal Reserve Bank of Atlanta has an agency at Savannah, Georgia, and operates another agency for the System at Havana, Cuba.

The Federal Reserve banks are under the general supervision of the Board of Governors of the Federal Reserve System. The capital of the Federal Reserve banks is supplied by the member banks, each of which is required to subscribe to the capital stock of its respective Reserve bank in an amount related to its own paid-up capital and surplus.

FEDERAL RESERVE DISTRICTS



[11]

Each Federal Reserve bank has a board of nine directors whose members are residents of the respective district and are required to administer the affairs of the Federal Reserve bank fairly and impartially. The terms of office of all directors are three years, so arranged that the term of one director of each class expires each year. Six of the nine directors are elected by the member banks of the district. These six include: three Class A directors, who must be representative of the member banks and who are usually active officers of member banks; and three Class B directors, who may not be officers, directors, or employees of any bank, but who must be actively engaged in their district in commerce, agriculture, or industry. For the election of directors, member banks are divided into three groups according to size of capital and surplus—small banks, medium-size banks, and large banks. Each group of member banks elects one Class A director and one Class B director.

The remaining three directors, who are called Class C directors, are appointed by the Board of Governors of the Federal Reserve System and may not be either officers, directors, employees, or stockholders of any bank. One of the Class C directors is designated by the Board of Governors of the Federal Reserve System as chairman of the board of directors and Federal Reserve agent. As Federal Reserve agent, he is the official representative of the Board of Governors and is required to maintain a local office of that body on the premises of the Federal Reserve bank. He administers such parts of banking law as are delegated to him, maintains a stock of Federal Reserve notes, and holds the collateral for such notes when issued. Examiners appointed with the approval of the Board of Governors of the Federal Reserve System examine State member banks. The Federal Reserve Agent keeps himself fully informed of the condition of all member banks.

Looking at the make-up of a Reserve bank board of directors in another way, Class A directors represent lenders of funds, Class B directors represent borrowers, and Class C directors represent the interests of the general public.

The chief executive officer of a Federal Reserve bank, effective March 1, 1936, is the president who, together with the first vice-president, is appointed for a term of 5 years by the board of directors with the approval of the Board of Governors of the Federal Reserve System. Other officers may be appointed by the board of directors of the Federal Reserve bank.

The Federal Reserve banks derive their funds for advances to member banks and for open-market purchases principally from the power conferred upon them by Congress to receive deposits and also to issue Federal Reserve notes. The principal sources of deposits of the Reserve banks are the member banks, which are required to keep with the Reserve banks reserve balances bearing a specified percentage relationship to the member banks' own deposit liabilities, and the United States Government.

The Reserve banks must hold a 40 per cent reserve in gold certificates against Federal Reserve notes in circulation and a 35 per cent reserve in gold certificates or other lawful money against deposits. When deposits with the Reserve banks are made in the form of gold certificates or lawful money, they add to the reserves of the Reserve banks and consequently increase their lending power by approximately two and one-half times the amount of the deposit. Deposits at the Reserve banks, however, may also be obtained by member banks through borrowing from the Reserve banks, or as a result of open-market purchases by these banks. Deposits obtained in these ways do not add to the reserves of the Reserve bank, or to their lending power, but, on the contrary, utilize some of the reserves and consequently absorb some of their lending power.

Federal Reserve banks are not operated for the purpose of making profits. It was the intention of Congress in enacting the Federal Reserve Act that the activities of the Federal Reserve banks be directed toward influencing credit conditions for the best interests of industry, agriculture, and commerce. Consequently, these banks in ordinary times have a large volume of cash assets and unused lending power. Since the Reserve banks hold the ultimate reserves of the banking system, it is important that the lending power of these banks be at all times adequate to meet not only the seasonal demands of trade and industry but also unusual requirements that may arise in exceptional circumstances.

After all necessary expenses of a Federal Reserve bank have been provided for, its stockholding member banks are entitled to receive a cumulative annual dividend of six per cent on the paid-in capital stock. On December 31, 1935, the paid-in stock of the Reserve banks held by the member banks totaled \$130,512,000, and dividends paid on this stock in 1935 were \$8,504,974. After dividend claims have been fully met, the net earnings are paid into the surplus fund of the Federal Reserve

bank, which strengthens the position of the bank and increases its ability to serve the public. More than one-fourth of the aggregate net earnings of the Reserve banks since their organization was paid to the Government as a franchise tax, approximately one-fourth was paid in dividends to member banks, nearly one-fourth, under act of Congress, was contributed to the capital of the Federal Deposit Insurance Corporation, and a fourth remains in the surplus accounts of the Reserve banks. In case of liquidation or dissolution of a Federal Reserve bank, any surplus remaining after payment of all debts, dividends, and the par value of its capital stock is to be paid to the United States Government.

The Member Banks—All national banks in the continental United States are required by law to be members of the Federal Reserve System, and eligible banks and trust companies operating under State charters may, with the approval of the Board of Governors of the Federal Reserve System, become members. Pertinent information with respect to membership in the Federal Reserve System is given in a later section.

About 40 per cent of the commercial banks in the United States were members of the System on December 31, 1935, and these member banks had resources amounting to about four-fifths of the total banking resources of all commercial banks in the country. There were 6,387 member banks on December 31, 1935, of which 5,386 were national banks and 1,001 were State banks. The State bank members ranged in size from banks with \$25,000 capital to some of the largest banks in the United States.

The relation of a member bank to the Federal Reserve bank of its district is similar in many respects to the relation of an individual to his bank. It is chiefly from member banks that Reserve banks receive deposits and to member banks that they make loans and supply currency.

Federal Advisory Council—The Federal Advisory Council is composed of twelve members, one from each Federal Reserve district, selected annually by the board of directors of the Federal Reserve bank of the district. The Council is required to meet in Washington at least four times each year, or oftener if called by the Board of Governors of the Federal Reserve System, and may hold such other meetings in Washington or elsewhere as the Council may deem necessary. The Council acts in an advisory capacity, conferring directly with the Board of Governors of the Federal Reserve System on general business

and financial conditions and making recommendations concerning matters within the Board's jurisdiction and the general affairs of the System.

THE WORK OF THE FEDERAL RESERVE BANKS

Among the principal functions of the Federal Reserve banks are holding the basic reserves of the banking system, issuing Federal Reserve notes, making discounts for or advances to member banks, purchasing and selling investments of the kinds permitted under the law, making direct loans to business and industry under certain conditions, clearing and collecting checks for member banks, safekeeping of securities for member banks outside of Reserve bank and branch cities, and acting as fiscal agents for the United States Treasury.

Holding Reserves of Member Banks—Every member bank is required by law to keep on deposit with its Federal Reserve bank a sum which bears a specified relation to its deposits. This is known as the member bank's reserve and, among other things, is responsible for the name, "Reserve" banks. Reserves required on time deposits are \$3 per \$100 in all classes of banks, while reserves required on demand deposits at the time this pamphlet was prepared were 13 per cent in central reserve city banks, 10 per cent in reserve city banks, and 7 per cent in other banks, known as "country banks."*

Changes in the volume of reserve balances carried by member banks with the Reserve banks are one of the most important indicators of credit conditions. Since member banks are required to hold a prescribed minimum proportion of reserves in relation to their deposit liabilities, and since in ordinary times banks do not carry a large amount of idle funds, changes in the volume of reserve balances ordinarily correspond to proportionate changes in deposits held by member banks. When member bank reserves increase because of gold imports or through purchases by the Reserve banks in the open market, the banks tend to increase their loans and investments, and consequently their deposits, until their volume is as large as the new reserve balances are permitted to support. On the other hand, if reserve balances are diminished through gold exports, sales of securities by the Reserve banks in the open market, or through a domestic demand for currency, member banks must

* Reserve requirements were progressively raised beginning with August 16, 1936, and by May 1, 1937, stood at double those given above. On April 16, 1938, however, the reserve requirement on net demand deposits was lowered to 23/4 per cent for central reserve city banks, 17 1/2 per cent for reserve city banks, and 12 per cent for country banks; that on time deposits was reduced to 5 per cent for all member banks.

either liquidate some of their loans and investments or borrow from the Reserve banks in order to bring their reserves up to the minimum required by law.

Since the reserves constitute only a fraction of the deposits that they are permitted to support, changes in reserves tend to be accompanied by changes in member bank deposits of several times the amount of the change. It is for this reason that reserve balances are sometimes referred to as "high power dollars."

The lower portion of the accompanying chart shows the course of member bank reserve balances from 1918 to 1935. Prior to 1932 these balances rarely exceeded the reserves required by law. Periods when reserve balances increased were periods when member banks were increasing their own loans and investments and deposits. Periods when member bank reserves diminished were periods when bank credit, as measured either by loans and investments or by deposits, declined. Increases in reserves, therefore, were indicative of periods of credit expansion, and decreases in reserves of periods of credit liquidation or contraction.

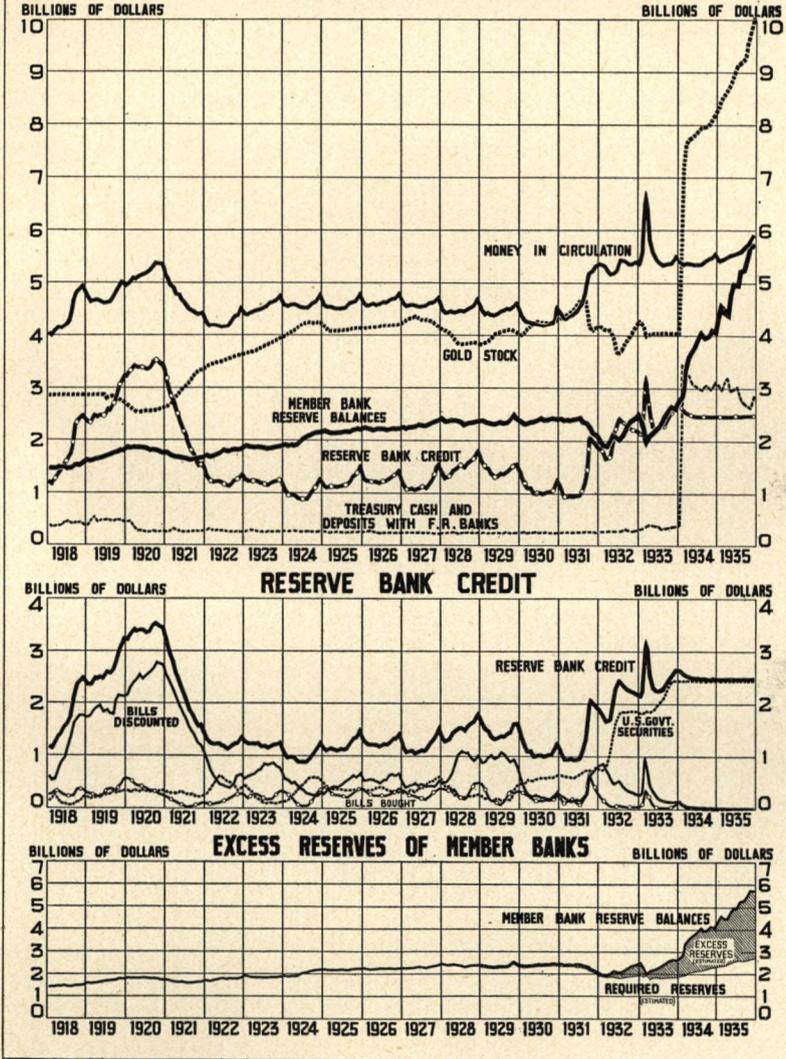
Not only changes in the volume of reserves of member banks are significant, but also the means that bring about these changes. If increases in reserves are caused by gold imports or open-market operations by the Reserve banks, they come to the member banks without causing them to borrow money, and consequently they result in a tendency on the part of the banks to find outlets for the new funds. In these circumstances credit conditions are easy and interest rates tend to decline. If, however, the member banks, in order to have the required amount of reserves, must borrow from the Reserve banks, then they are likely to make efforts to get out of debt, and may sell investments or call loans. Credit conditions become tight and interest rates advance.

For these reasons, the Reserve banks can exert an important influence on credit conditions by increasing or decreasing the volume of member bank reserves by buying or selling securities in the open market.

Since 1932 the demand for bank credit by business has been inactive, while reserves of member banks have been greatly increased, first, through open-market operations by the Reserve banks, and later through large imports of gold from abroad. As a consequence, member bank reserve balances with the Federal Reserve banks have been much larger than the minimum

MEMBER BANK RESERVES AND RELATED FACTORS

MONTHLY AVERAGES OF DAILY FIGURES



required by law. These reserves above legal requirements are known as excess reserves. The continued expansion of these excess reserves was in accordance with the Federal Reserve System's policy of easy money pursued for the purpose of lowering prevailing money rates and encouraging the recovery of business.

Some of the principal factors, changes in which influence the volume of member bank reserve balances, are also shown on the chart.* Gold stock and Reserve bank credit may be considered as primary sources of reserve funds. If other factors do not change, additions to the country's gold stock increase bank reserves and ease conditions in the money market, while reductions in gold stock have the opposite effect. Like effects follow increases or decreases of Reserve bank credit. The principal components of Reserve bank credit are shown in the middle section of the chart and comprise bills discounted for member banks, bills bought in the open market by the Reserve banks, and holdings of United States Government securities by the Reserve banks. As already indicated, it makes a difference whether changes in reserves are caused by open-market purchases by the Reserve banks, or reflect borrowing by member banks from the Reserve banks.

"Money in circulation" and "Treasury cash and deposits with Federal Reserve banks," which are also shown on the chart, are sometimes spoken of as factors making use of reserve funds. Increases and decreases in these work in the opposite direction from changes in gold and Reserve bank credit. A member bank needing currency to meet customers' demands may get it from a Reserve bank and have the amount charged to its reserve account. On the other hand, a member bank with surplus currency on hand may deposit it, receiving credit in its reserve account. Additions to funds withdrawn by the Treasury from the banks and held on deposit with the Federal Reserve banks or as cash in the Treasury vaults result in a decrease in reserve balances of member banks or an increase in their borrowings, while disbursements of such funds by the Treasury have the opposite effect.

The Federal Reserve banks may be thought of as a system of twelve reservoirs, each holding the reserve deposits of member banks and prepared to make loans to meet the credit needs

* A full discussion of the derivation of this chart and the significance of its constituent items may be found in the Federal Reserve Bulletin, July 1935, and in "Money Rates and Money Markets in the United States," by Winfield W. Riedler, Harper & Brothers, Publishers, 1930.

of its respective district. Facilities for borrowing on sound assets at its Reserve bank are an assurance to a well-managed bank of its capacity to render better service to its industrial, commercial, and agricultural customers.

In actual practice, a member bank's reserve account at the Reserve bank may be increased by depositing currency or checks, by transfers from a correspondent bank, by borrowing at the Reserve bank, or by the sale to the Reserve bank of bankers' acceptances, or under certain circumstances, by the sale to the Reserve bank of Government securities or other assets which the Reserve banks may purchase. The reserve balance may be checked against by the member bank, but any deficiency in the required balance must be restored.

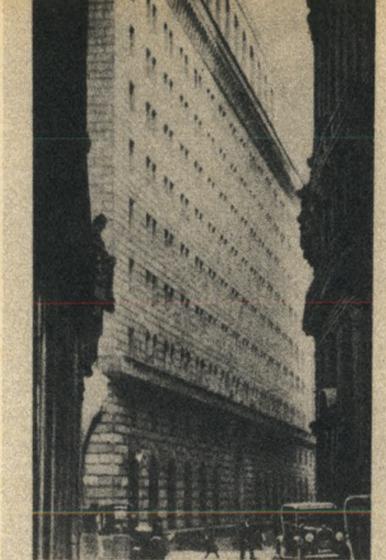
No interest is paid on member bank reserve deposits. If interest were paid on such deposits, Reserve banks would need to be so operated as to earn the interest and would have to keep their funds more fully invested, thus competing directly with commercial banks for loans and investments. Since the public interest requires that the operations of the Reserve banks be conducted with reference to the general condition of credit and business rather than to the need for earnings, the Reserve banks are not permitted to pay interest on deposits.

Extension of Credit by Federal Reserve Banks—The power of the Reserve banks to extend credit is of great importance to the business public. Let us take as an example a grocer in Austin, Texas, who wishes to buy a carload of flour. At the moment his bank account is not sufficient to cover such a purchase, and so he applies to his local bank for a loan. The bank, satisfied with the grocer's credit rating, makes him a 90-day loan on his note, and the grocer then buys the flour. As he sells it and his customers pay their bills, the grocer accumulates funds to retire his note.

In ordinary circumstances, a bank's resources are sufficient to meet its customers' requirements, but the grocer's application for a loan may reach his bank at a time when many other customers need business loans. If the bank expands its loans at this time, it may in turn be forced to borrow. Before the establishment of the Federal Reserve System the Austin bank would have applied for a loan from some other bank with which it had an account. Usually, correspondent banks can meet requirements of this character coming from their bank customers. However, the correspondent bank similarly might not be in a position to expand its loans.



BOSTON

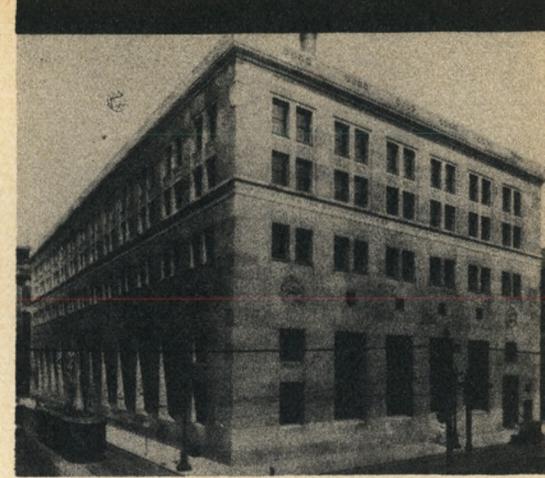


NEW YORK

THE
TWELVE
FEDERAL
RESERVE
BANKS




CHICAGO



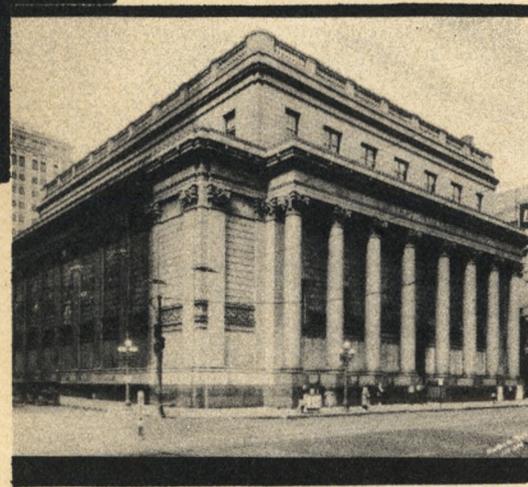
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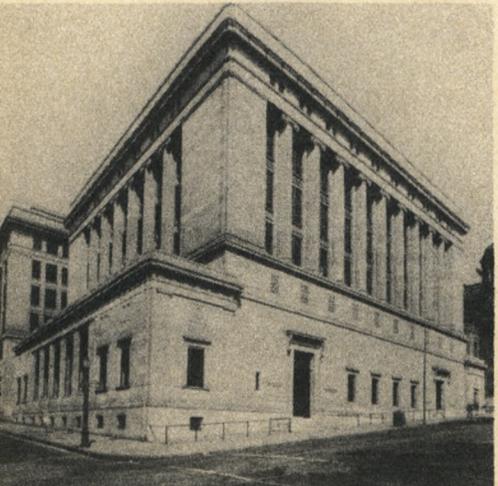
CLEVELAND



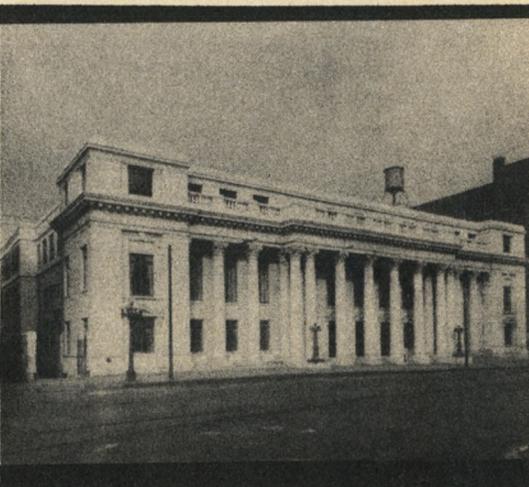
MINNEAPOLIS



KANSAS CITY



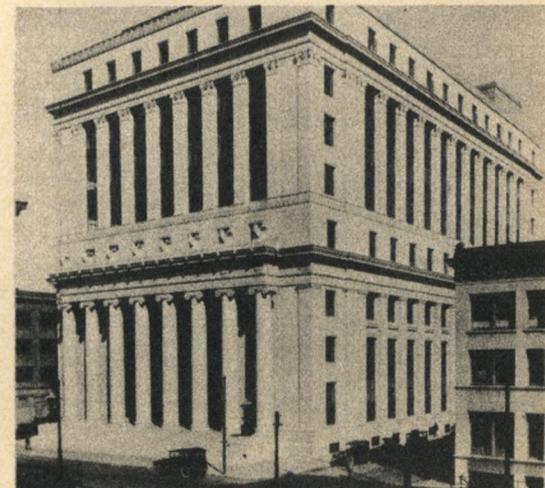
RICHMOND



ATLANTA



DALLAS



SAN FRANCISCO

Since the passage of the Federal Reserve Act, the Austin bank, if a member of the Federal Reserve System, is in a much more secure position, since it can always turn to the Reserve Bank of Dallas. It may offer to the Reserve bank the grocer's note. The Reserve bank then examines the note as to its eligibility under the law and as to its soundness, and, if satisfied with the loan, rediscounts it and places the proceeds in the reserve account of the Austin bank.

Later, when the grocer's note matures and is paid, it is returned to him and thus the circle is completed. Meanwhile, the grocer has been able to carry on his business. The Austin member bank, with the funds it borrowed from the Reserve bank, has been better able to serve its customers than would have been the case if the reserve reservoir had not been available to draw upon.

The rate of interest charged the member bank by the Reserve bank is called the "discount rate." The discount rate for each class of paper is required to be established every fourteen days by each Reserve bank, or oftener if deemed necessary by the Board of Governors of the Federal Reserve System, and is subject to review and determination by the Board of Governors. Such rate is applied uniformly to all member banks in the district on paper of like character and is usually lower than the rate charged its customers by a member bank.

The member bank's lending rate at any particular moment is determined, subject to State law, largely by custom and business conditions. On the other hand, the discount rate at a Reserve bank is determined largely with reference to credit conditions. Discount rates are advanced when there is evidence of excessive growth of credit or the development of speculative activity and reduced when business is inactive and the demand for credit is low.

Federal Reserve banks may borrow from each other by rediscounting loans which they have made.

Important types of credit extension in which the Federal Reserve banks may engage are described below in summary form:

Credit Facilities for Member Banks—Reserve banks are authorized to discount for their member banks eligible paper which consists of notes, drafts, bills of exchange, and bankers' acceptances of short maturities arising out of commercial, industrial, and agricultural transactions, and short-term paper secured

by obligations of the United States. They are authorized to make advances to their member banks upon the promissory notes of the latter for periods not exceeding ninety days upon the security of paper eligible for discount or purchase and for periods not exceeding fifteen days upon the security of obligations of the United States and certain other securities.

Federal Reserve banks may also make advances to member banks on other kinds of security, namely, upon any assets of the member bank whether otherwise eligible or not, which will secure the loan to the satisfaction of the lending Reserve bank. Such loans may have a maturity of not more than four months and bear interest at a rate of not less than $\frac{1}{2}$ of 1 per cent per annum higher than the highest discount rate at the time in effect at such Reserve bank. Under certain prescribed conditions, advances may also be made to groups of member banks upon collateral other than eligible paper.

Credit Facilities for Others—Federal Reserve banks may make working capital loans direct to established industrial or commercial businesses which are unable to secure needed credit from their usual sources. These loans may be for periods not exceeding five years. Federal Reserve banks may also participate with member banks or other financial institutions in making such loans. A third form of this Federal Reserve bank assistance to industry is for a member or nonmember bank to make the loan, first protecting itself by securing a commitment from the Federal Reserve bank. The commitment binds the Federal Reserve bank to take over the loan at the request of the lending bank and to assume an agreed proportion of any loss, in no case exceeding 80 per cent of the loan.

Federal Reserve banks may also make advances to individuals, partnerships, or corporations upon their notes secured by direct obligations of the United States for periods not exceeding ninety days. In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System may authorize a Federal Reserve bank under certain conditions to discount for individuals, partnerships, or corporations notes, drafts, and bills of exchange of the kinds and maturities made eligible for discount for member banks. Federal Reserve banks may discount short-term agricultural paper for Federal Intermediate Credit banks.

Open-Market Investments—Federal Reserve banks, in accordance with the direction and regulations of the Federal Open Market Committee, may purchase and sell in the open market bankers' acceptances, cable transfers, and bills of exchange of the kinds and maturities eligible for discount, and direct obligations of the United States or obligations which are fully guaranteed by the United States as to principal and interest, as well as certain short-term obligations of Federal Intermediate Credit banks, of National Agricultural Credit Corporations, and of States in the continental United States and political subdivisions thereof. These operations are an important phase of the System's credit-extension activities.

Currency—Currency in this country has become the "small change" of business. The greater part of the country's transactions is settled by check, and except when banking disturbances have resulted in hoarding of currency by the public, the amount of currency in circulation has varied chiefly with the need for cash in making retail purchases and in paying wages.

The Federal Reserve banks are the principal currency reservoirs of the United States, and their own note issues afford the elastic element in the American currency supply. Member banks obtain the currency that they pay out from the Federal Reserve bank of their district. Nonmember banks usually obtain their currency from their correspondent banks, which are members of the Federal Reserve System and order the currency in turn from the Federal Reserve bank.

Currency transactions between a member bank and a Federal Reserve bank are much the same as those between an ordinary bank and its depositors. When an individual needs currency, he draws a check on his bank and cashes it. If he does not have a sufficient balance in the bank to obtain funds in this manner, he may be forced to borrow. Similarly, when a member bank requires currency to pay out to its customers, it in effect draws and cashes a check on its Federal Reserve bank. The member bank may find it necessary to borrow at the Federal Reserve bank for this purpose.

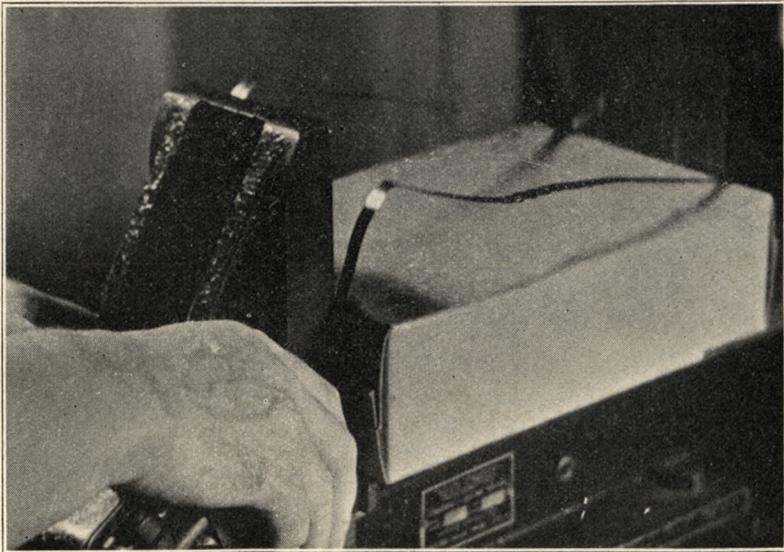
On the other hand, when an individual has more currency than he needs, he deposits it at his bank, perhaps paying off a loan. Likewise, if a member bank decides that it has more currency than it needs, it will return the surplus currency to the Reserve bank for credit to its account. Thus, the increase or decrease in the volume of currency in circulation does not depend

upon the initiative of the Federal Reserve banks but upon the needs of the member banks. Their needs, in turn, are determined by the needs of their customers.

The entire cost of shipping currency to and from member banks is paid by the Federal Reserve banks.

In order to be able to supply all calls for currency without delay, the Federal Reserve banks keep on hand large stocks of all denominations of currency and coin. Additional stocks of paper currency are also maintained at the Bureau of Engraving and Printing in Washington, D. C.

As banks of issue, the Federal Reserve banks have had outstanding both Federal Reserve notes and Federal Reserve bank notes. Federal Reserve notes constitute the major portion of the currency used in the United States today, about \$3,700,000,000 being in circulation during December 1935. Federal Reserve bank notes, however, have been issued only under special conditions. The amount outstanding at any time has been relatively small and those issued during the 1933 banking emergency are rapidly disappearing from circulation.



A cardboard carton of currency being strapped for shipment by a Reserve bank to a member bank. Steel bands are placed around each package while it is compressed between the jaws of the machine.

Federal Reserve notes are obligations of the United States and are a first and paramount lien on all the assets of the issuing Federal Reserve bank. They are legal tender for all public and private debts.

Any Federal Reserve bank may make application to its Federal Reserve agent for Federal Reserve notes. They are issued by the Federal Reserve agent against the security of gold certificates and of commercial and agricultural paper discounted or purchased by Federal Reserve banks, and, until March 3, 1937,* may also be secured by direct obligations of the United States when authorized by the Board of Governors of the Federal Re-



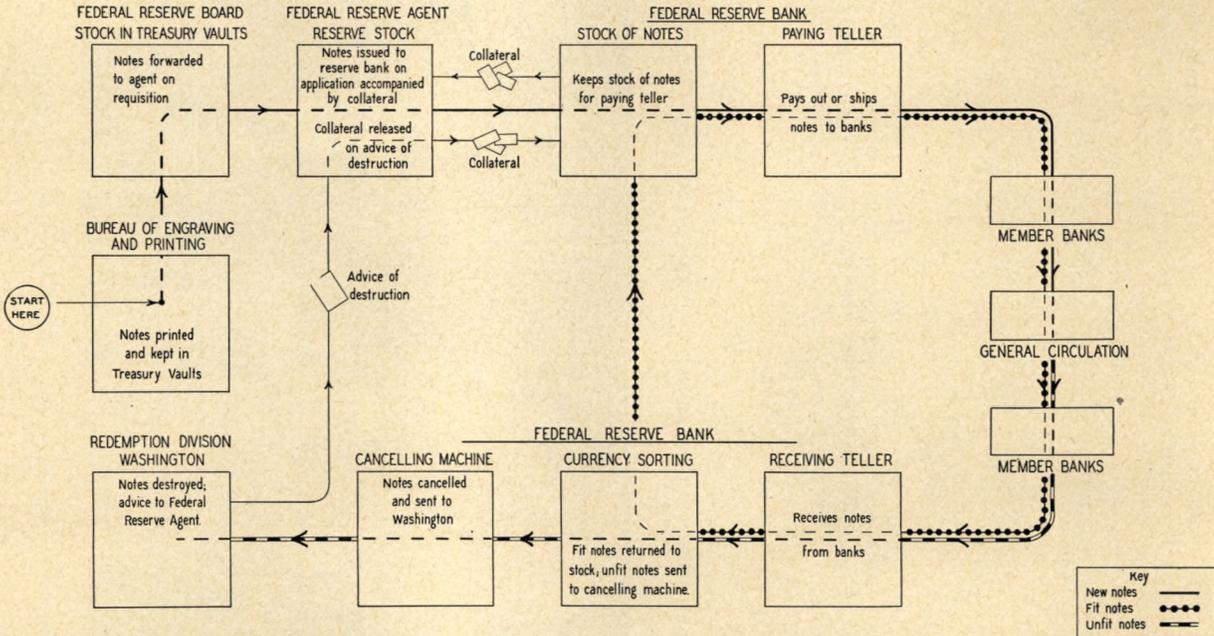
The packages shown in the above illustration are new and used Federal Reserve notes being issued by the Federal Reserve agent to the Federal Reserve bank.

serve System. Every Federal Reserve bank is required to maintain reserves in gold certificates of not less than 40 per cent against its Federal Reserve notes in circulation. A small fund in gold certificates is maintained with the Treasurer of the United States for the redemption of its Federal Reserve notes, but this may be counted as part of the 40 per cent reserve.

* Extended to June 30, 1939.

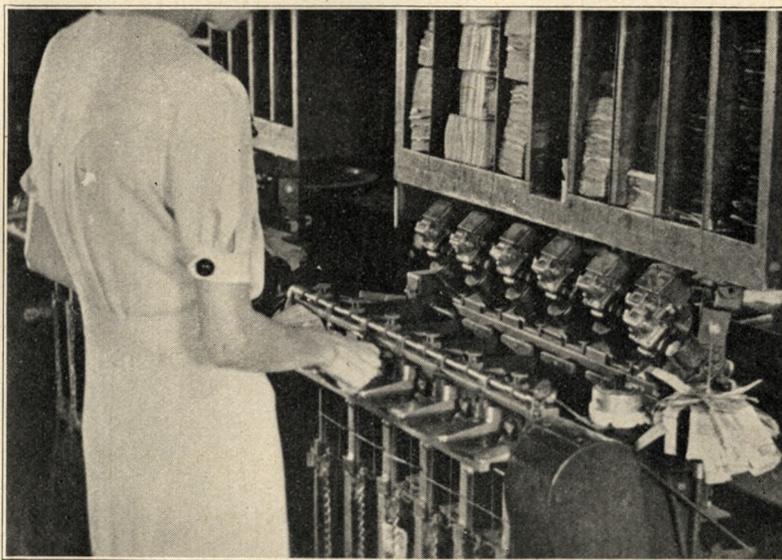
ISSUE AND RETIREMENT OF FEDERAL RESERVE NOTES

[27]



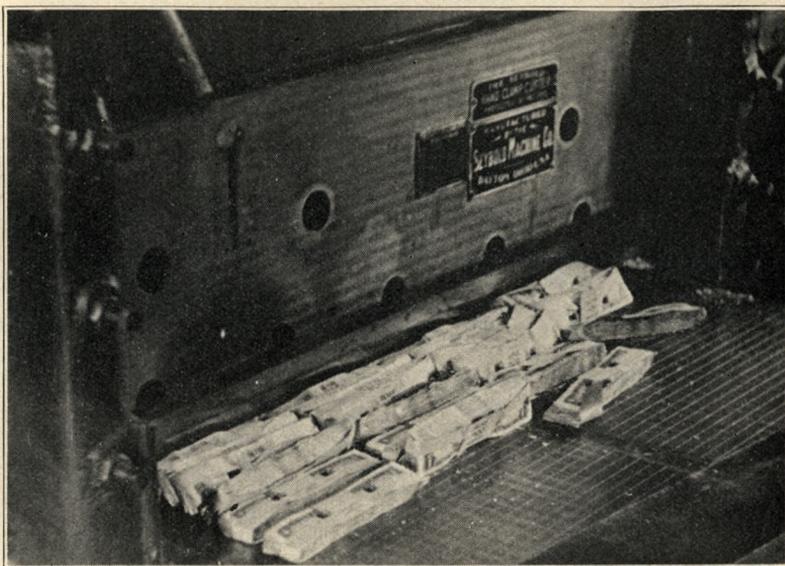
The collateral pledged with the agent by the Reserve bank for Federal Reserve notes must not be less than the amount of notes applied for. The Board of Governors of the Federal Reserve System may at any time call upon the Federal Reserve bank for additional security to protect Federal Reserve notes issued to it.

Every Reserve bank is required to redeem in lawful money its own Federal Reserve notes and the notes issued by other Reserve banks, but it may not place the notes of other Federal Reserve banks in circulation again under a penalty of a tax of 10 per cent upon the face value of the notes so paid out. It is required to return promptly to every other Reserve bank the notes of such other Reserve bank, or, upon direction of that bank, to forward them to the Treasurer of the United States for retirement. Badly worn and mutilated notes are canceled and returned by the Federal Reserve bank receiving them to Washington. Notes which are still fit for use may be returned by a Reserve bank to the custody of its Federal Reserve agent, and the former is then entitled to the return of an equivalent amount



Currency returned to the Reserve banks is sorted by machines of the type shown in this illustration.

of collateral. Returned notes may again be obtained from the agent on the presentation of collateral as required for the issue of new notes. The costs of engraving, printing, issuing, and retiring Federal Reserve notes, together with insurance and shipping costs, are paid by the Reserve banks.

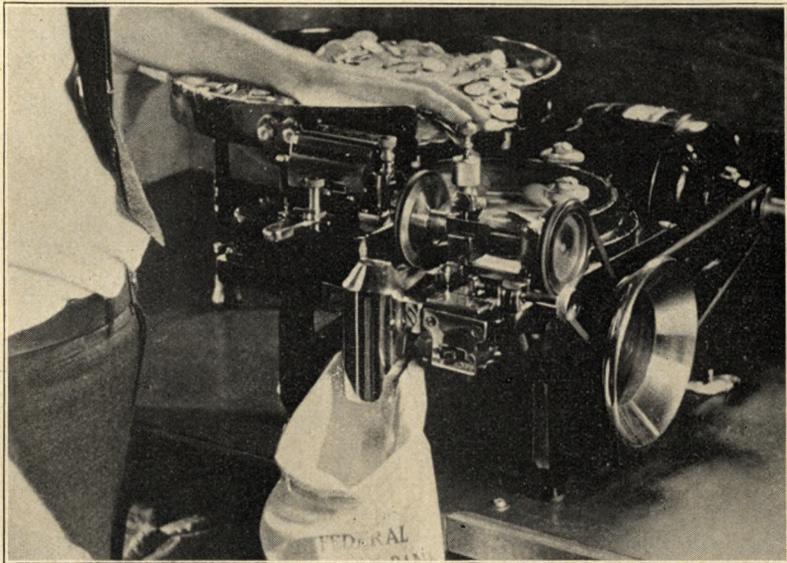


Currency which returns to the Reserve banks unfit for further use, is cut in two by this machine and the two halves sent in separate shipments to Washington.

The facilities provided by the Federal Reserve System for borrowing on sound assets to obtain currency represent one of the most important improvements made in the American financial system by the Federal Reserve Act. Previously, when there was a sudden increase in the demand for currency, a large supply was difficult to obtain: First, because facilities for issuing sufficient currency to meet emergency demands did not exist; and second, because there was no central pool from which banks could borrow, while in times of banking difficulty large-scale sales of investments or borrowing from other banks was impossible. The impossibility of increasing the supply of currency was one of the principal causes of the panics of 1873, 1893, and 1907, when many banks suspended payments to depositors, notwithstanding the fact that they owned sound assets of the types

on which the Federal Reserve banks now extend credit. The Federal Reserve System established an elastic currency system, which made it possible to meet the unprecedented withdrawals of cash in the years 1930-1933.

The demand for currency is one of the principal sources of the seasonal demand for Reserve bank credit. This is shown by the chart on page 17, on which one line represents the total of credit extended by Reserve banks from January 1918 through December 1935, and a second line, volume of money in circulation. The close relationship of the seasonal fluctuations in Reserve bank credit and in currency is at once evident.



A coin-counting machine in a Reserve bank. In 1934 nearly \$300,000,000 of coin was received and counted at the twelve Reserve banks.

Interdistrict Settlement Fund—Each Federal Reserve bank has a deposit of gold certificates with the Board of Governors at Washington. The sum of the twelve deposits is called the Interdistrict Settlement Fund, which was created to assist Federal Reserve banks in settling their transactions with each other. Private or leased wires connect all Federal Reserve banks and branches, and at the close of each day the Reserve banks wire

to Washington the total of the amounts that they owe the other Reserve banks. The Interdistrict Settlement Fund combines these figures and transfers sums from one bank's account in the fund to another's account to pay the net amount of these inter-bank transactions. In this way check collections, transfers of funds for member banks and the Treasury, Federal Reserve bank investments, and an enormous mass of other interdistrict business are transacted merely by bookkeeping entries and without physical shipments of currency. In 1935, business totaling \$91,000,000,000 was handled through the Interdistrict Settlement Fund.

Check Collection—Under regulations prescribed by the Board of Governors of the Federal Reserve System, the twelve Federal Reserve banks act as a nation-wide clearing house for their member banks and for such nonmember banks as maintain appropriate balances with the Reserve banks. For these banks the Federal Reserve banks will collect checks drawn on all banks in the United States which do not deduct an "exchange charge" for paying checks on themselves received through the mail. Out-of-town checks drawn on banks in the same Federal Reserve



Bundles of incoming checks being opened in the mail department of a Reserve bank.

district deposited with a Reserve bank are usually sent directly to the banks on which drawn. Checks drawn on banks in another Federal Reserve district, however, are ordinarily sent to the Reserve bank of that district for presentation. This payment between Federal Reserve banks for the proceeds of check collections is made by telegraph through the Interdistrict Settlement Fund. Direct forwarding of checks and settlement of interdistrict items through the Interdistrict Settlement Fund have reduced materially the average time formerly required to collect out-of-town checks under the old indirect routing practice. Since upwards of 90 per cent of all commercial transactions are settled by checks, the more prompt availability of the proceeds of checks represents an important saving to business and banking in this country. Moreover, checks are collected by the Federal Reserve banks without payment of the old "exchange charge" and this represents a large saving to commerce.



Sorting U. S. Treasury checks in a Reserve bank. Each pile of checks is drawn for a different purpose and by a different disbursing officer of the Government.

Collection of Notes, Drafts, Bonds, Coupons, etc.—The Federal Reserve banks also collect miscellaneous items such as notes, drafts, bonds, coupons, etc., collection being made through direct routing and the use of the Interdistrict Settlement Fund in much the same manner as checks.

Wire Transfers of Funds—Member banks wishing to create balances or pay funds in another part of the country may do so by means of wire transfers through their Reserve banks without loss of time and, if transfers are for multiples of \$100, at no cost to member banks except where made for the benefit of a designated customer, when a charge is made for the cost of the telegram. These transfers are accomplished by means of wire advices from the sending to the receiving Federal Reserve bank, and payment is made through the medium of the Interdistrict Settlement Fund.



A clerk in a Federal Reserve bank counting coupons from various U. S. Treasury securities after redemption by the Reserve bank as Fiscal Agent for the Government.

Fiscal Agency—The Reserve banks act as fiscal agents of the Government in the issue, transfer, exchange, conversion, and redemption of United States Government securities, and in the administration of special deposit accounts of the Government in

member and nonmember banks. Functions formerly performed by the Sub-Treasuries of the United States in connection with the exchange and redemption of money for the public are handled now by the Reserve banks. They are also called upon to serve as fiscal agents for various agencies and corporations established by the Government, as for example, the Reconstruction Finance Corporation. The Fiscal Agency Department of a Federal Reserve bank is a convenience to banks and the public having occasion to deal with the Government in these matters.

Informational Services of the Federal Reserve System—Important work is carried on by the Board of Governors of the Federal Reserve System as well as at the Reserve banks in the collection and analysis of financial and business data of local, national, and international scope. Accurate and current information of this character is essential to the officials of the System who are responsible for national credit policies. The material thus assembled is made public as far as possible for the benefit of member banks and business in general.

The official publication of the Board of Governors of the Federal Reserve System, the Federal Reserve Bulletin, is issued monthly and is supplied free of charge to all member banks, and at a subscription rate of \$2.00 per year to cover printing costs, to the general public. It is a source for statistical material dealing with general business conditions, the operations of the Federal Reserve banks and member banks, money market developments in this country, and foreign banking data, including exchange rates, gold holdings of central banks and governments, reports of central banks, and similar material.

A monthly review of business conditions in its district is issued by each Federal Reserve bank. These reviews are based in part on reports received from banks and from firms representing the major lines of industry, and are designed to include the type of information currently useful to bankers in their lending activities. In addition to the monthly reviews of business conditions, a large amount of statistical matter for the use of officers and directors is prepared at each Federal Reserve bank. Several of the Reserve banks maintain libraries which are open to the public, affording access to collections of well-selected books, pamphlets, and current periodicals on economic and financial subjects.

GENERAL INFORMATION REGARDING MEMBERSHIP
IN THE FEDERAL RESERVE SYSTEM

Among the privileges which a bank enjoys as a member of the Federal Reserve System are the following:

1. Facilities for rediscounting eligible paper and obtaining advances on promissory notes.
2. Obtaining currency and coin promptly when needed.
3. Direct use of Federal Reserve check collection facilities.
4. Direct use of Federal Reserve non-cash collection service.
5. Transferring funds by telegraph.
6. Drawing drafts on Federal Reserve bank.
7. Safekeeping of securities by the Federal Reserve bank for member banks located outside of Federal Reserve bank and branch cities.

8. Use of the emblem



9. Member bank deposits are automatically insured by the Federal Deposit Insurance Corporation up to \$5,000 for any one depositor.

As stated above, all national banks in the continental United States are required to become members of the Federal Reserve System. In the case of State banking institutions interested in becoming members, applications should be addressed to the Federal Reserve agent at the Reserve bank in the district in which the applicant is located. The Federal Reserve agent investigates the condition of the bank and makes recommendations to the Board of Governors of the Federal Reserve System, which must pass on each application for membership.

In acting upon the application of a State institution for membership, the Board gives special consideration to:

- (1) The financial history and condition of the applying bank and the general character of its management;
- (2) The adequacy of its capital structure and its future earnings prospects;

- (3) The convenience and needs of the community to be served by the bank; and
- (4) Whether its corporate powers are consistent with the purposes of the Federal Reserve Act.

Some of the important statutory provisions regarding membership are outlined below.

Capital required—To be eligible for admission to membership in the Federal Reserve System, a State bank or trust company, including Morris Plan banks and other incorporated banking institutions engaged in similar business but excepting mutual savings banks having no capital stock, must have a paid-up, unimpaired capital sufficient to entitle it to become a national bank in the place where it is situated, except that this requirement does not apply to certain State banks and trust companies having a capital of not less than \$25,000.

After the year 1941 the above requirement may be waived by the Board of Governors of the Federal Reserve System with respect to the State banks and trust companies having average deposits of \$1,000,000 or more, which after that year are required to be members of the Federal Reserve System, in order to have the benefits of deposit insurance.*

A mutual savings bank having no capital stock must, to be eligible, have surplus and undivided profits of not less than the amount of capital required to organize a national bank in the same place.

The minimum capital requirements with respect to new national banks are as follows:

In cities having population of:	Minimum Capital Required
6,000 or less.....	\$ 50,000
Over 6,000 but not over 50,000.....	100,000
Over 50,000 (except as stated below).....	200,000
In an outlying district of a city with a population exceeding 50,000 inhabitants; provided State law permits organization of State banks in such location with a capital of \$100,000 or less.....	100,000

Stock Subscription—An applying bank is required to subscribe for stock in the Federal Reserve bank of the district in an amount equal to 6 per cent of its paid-up capital and surplus (including capital notes and debentures sold to the Reconstruction Finance Corporation), except that a mutual savings bank

* Savings banks, mutual savings banks, Morris Plan banks and other incorporated banking institutions engaged only in business similar to that transacted by Morris Plan banks, State trust companies doing no commercial banking business, and banks located in Hawaii, Alaska, Puerto Rico, or the Virgin Islands, are not required to become members of the Federal Reserve System in order to have deposit insurance.

must subscribe for an amount of stock equal to six-tenths of one per cent of its total deposits. Only one-half of the par value of the stock is paid, the other half remaining subject to call by the Board of Governors of the Federal Reserve System. Upon the amount paid in, the Reserve bank pays cumulative dividends at the rate of 6 per cent per annum.

Reserve Requirements—A member bank must maintain with its Federal Reserve bank as a reserve balance a certain proportion of its deposits. This proportion varies according to the class of the deposit and the location of the bank, as follows:

Member Banks:	Net Demand Deposits*†	Time Deposits†
(a) In central reserve cities.....	13%	3%
(b) In reserve cities.....	10%	3%
(c) Elsewhere.....	7%	3%

* Gross demand deposits less balances due from other banks and cash items in process of collection payable immediately upon presentation in the United States.

† See page 15 for subsequent changes in these requirements.

If located in an outlying district of a reserve city, however, a member bank may, upon approval of the Board of Governors of the Federal Reserve System, have its reserve requirements reduced to those specified in (c), and, if located in an outlying district of a central reserve city, may, with the approval of the Board of Governors of the Federal Reserve System, have its reserve requirements reduced to those specified in (b) or (c).

The Board of Governors of the Federal Reserve System may, in order to prevent injurious credit contraction or expansion, change the requirements for reserves of member banks located in reserve and central reserve cities or of those located elsewhere or of all member banks, but such reserves shall not be less than the percentages of deposits shown in the above schedule nor more than twice such percentages.

The law provides that no new loans may be made nor any dividends paid by a member bank if its reserve is deficient. Penalties which are prescribed by the Board of Governors of the Federal Reserve System are assessed for deficiencies in a bank's reserves. Deficiencies are computed on the basis of the average daily net deposit balances for semi-weekly, weekly, or semi-monthly periods for banks located in Federal Reserve and branch cities, reserve cities, and elsewhere, respectively.

Voluntary Withdrawal—Any State member bank or trust company may withdraw from membership after six months' written notice has been given to the Board of Governors of the

Federal Reserve System, upon the surrender and cancellation of all of its holdings of Federal Reserve bank stock, but, in exceptional circumstances, such six months' notice may be waived by the Board in individual cases. The law provides, however, that no Federal Reserve bank shall, except upon express authority of the Board, cancel within the same calendar year more than 25 per cent of its capital stock on account of such voluntary withdrawals during that year.

Examinations and Reports—National banks and their affiliates are examined by the Comptroller of the Currency and copies of the reports are furnished the Reserve bank. State member banks and their affiliates are examined by examiners appointed with the approval of the Board of Governors of the Federal Reserve System; and, whenever the directors of a Federal Reserve bank approve examinations made by the State authorities, such examinations and the reports thereof may be accepted in lieu of examinations made by examiners so appointed and approved. The Board of Governors of the Federal Reserve System deems it desirable to have at least one regular examination of each State member bank, including its trust department, made during each calendar year by a Federal Reserve bank's examiners either independently or jointly with State banking authorities. The laws of some States authorize the acceptance of the reports of examiners for the Federal Reserve banks in lieu of examinations by State examiners.

A State member bank is required to furnish its Federal Reserve bank semi-annual reports of earnings and dividends and not less than three reports of condition each year, including reports of its affiliates (with certain exceptions), and to publish such reports of condition. A national bank sends to its Federal Reserve bank copies of similar reports which it submits to the Comptroller of the Currency. A member bank must also furnish its Reserve bank with periodical reports of daily net deposit balances for reserve computation purposes.

Branches of State Member Banks—State member banks may establish and operate branches on the same conditions and subject to the same limitations as those applicable to national banks, subject to the provisions of the laws of the State in which they are located, and subject also to the approval of the Board of Governors of the Federal Reserve System with respect to the

establishment of out-of-town branches. The Board's approval is not required for branches within the city, town, or village in which the parent bank is situated.

Limitation on Interest Paid on Deposits—No member bank of the Federal Reserve System may pay interest on any deposit which is payable on demand, with certain specified exceptions; and the Board of Governors of the Federal Reserve System is required by law to limit by regulation the rate of interest which may be paid by member banks on time and savings deposits.

Miscellaneous Provisions—There are a number of other provisions of Federal law relating to different aspects of operations of national banks as well as State banks which become members of the Federal Reserve System. Each member bank must have not less than 5 nor more than 25 directors. There are provisions regulating loans to a bank's own executive officers; providing for the removal of any director or officer for violation of law or for continued unsafe or unsound banking practices; limiting the degree to which directors, officers, or employes of member banks may serve other banks or securities organizations; and imposing penalties with respect to embezzlements, false entries, and similar matters.

Other important provisions prohibit member banks from lending on or purchasing their own stock; prohibit payment of unearned dividends; limit activities with respect to purchasing, selling, underwriting, and holding investment securities and stock; regulate the relation of a member bank to holding company affiliates; prohibit affiliation with any organization engaged principally in the issue, underwriting, or distribution of securities; limit loans on stock or bond collateral; limit loans to or investments in stock of affiliates; and limit the investment in bank premises.

Conditions of Membership—The Board of Governors of the Federal Reserve System prescribes for each State institution applying for membership conditions to which the institution must agree before it is admitted to the System. These conditions are designed to maintain high standards in member banks and to insure that powers exercised after their admission will be consistent with the provisions of the Federal Reserve Act.

The Federal Reserve agent in each district is prepared to furnish on request full information as to the procedure to be followed and forms to be used in applying for membership.

In its more than twenty years of operation and development, the Federal Reserve System has become an integral part of American business and finance. Through the Interdistrict Settlement Fund it has made possible the more efficient, less costly, and speedier handling by member banks of check collections and transfers of funds. It has provided an elastic and adequate supply of currency, a concentration of bank reserves for greater usefulness, and an efficient fiscal agency for the Treasury. The ability of member banks to borrow on business paper which provides a ready market for the loans of customers, large and small, has tended to equalize the credit supply in all parts of the country, to eliminate seasonal credit strain, and give greater assurance that member banks can supply the credit requirements of their communities. Machinery has been set up to provide a national credit policy administered in the public interest and to insure unified action by the banking system in carrying out this policy.
