CIRCULAR No. 62.

Superseded by 207

FEDERAL RESERVE BANK
OF NEW YORK

NEW YORK, January 15th, 1917.

PENALTIES FOR DEFICIENT RESERVE BALANCES OF MEMBER BANKS IN THE FEDERAL RESERVE BANK

To THE CASHIER,

SIR:

In our Circular No. 43 of June 6, 1916, we advised member banks regarding the penalties under the Federal Reserve Act for deficiencies in reserve balances carried by them with this bank, but in view of the number of questions we have recently been asked concerning such penalties we deem it advisable to call again the attention of the member banks to the following:

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

> "The reserve 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the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities; provided, however, that no bank shall at any time make new loans or shall pay any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 1916) 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 the 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 per cent. per annum above the 90-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."

Circular No. 43, issued by the Federal Reserve Bank of New York, on June 6, 1916, reads in part as follows:

> "With the inauguration of the collection system, the penalty for impairment of reserves, provided by the Federal Reserve Act, will be imposed. You will be requested to report monthly the average reserve required to be kept with the Federal reserve bank. Impairment of this reserve, if any, will be ascertained by comparing this figure with the average actual reserve shown by our books."

You will observe that while the reserves of member banks in the Reserve Bank are subject to withdrawal by check, the Federal Reserve Act requires penalties to be imposed for deficiencies in reserves. The penalty, which has been fixed by the Federal Reserve Board for the present "at 2% above the 90 day discount rate," is at the rate of 6% per annum. The practice of this bank has been to calculate reserves on the basis of a monthly average, and when reserve balances are likely to become impaired most member banks prefer to rediscount with the Reserve Bank to maintain them rather than pay the penalty.

A recent amendment to the Federal Reserve Act gives member banks the privilege of borrowing from this bank, for periods not exceeding 15 days, on their own notes secured by paper eligible for rediscount (which paper may have a maturity not exceeding 90 days). As our present discount rate is 3% for such notes having not more than 15 days to run, member banks have found them a useful form of borrowing to avoid temporary deficiencies in reserve balances.

Respectfully,

R. H. TREMAN,

Deputy Governor.