

July 19, 1917.

To the Federal Reserve Board and
The Comptroller of the Currency.

Gentlemen :

As joint counsel for the Federal Reserve Board and the Comptroller of the Currency, this office has been requested to file an opinion on the subject of what, if any, deductions may be made from the liabilities of member banks in determining the amount against which reserve must be carried.

Section 19 of the Federal Reserve Act, as amended by the Acts approved August 15, 1914, and June 21, 1917, definitely fixes the amount and character of reserve to be maintained. Each member bank is required to maintain with the Federal reserve bank of its district an actual net balance equal to not less than a fixed per cent of the aggregate of its demand deposits and a fixed per cent of its time deposits. The amount fixed varies according to whether the banks are located in reserve, central reserve, or non-reserve cities, but with the exception of the variations in the amount the requirements are identical in each case.

Demand deposits are expressly defined as all deposits payable within thirty days.

Time deposits, under the terms of the Act, comprise all deposits payable after thirty days, all savings accounts and certificates of deposit which are subject to not less than thirty days' notice before payment, and all postal savings deposits.

Demand deposits may include -

- (a) Individual deposits.
- (b) Government deposits.
- (c) Bank deposits.

(a) No provision of the Act can be construed as authorizing any deduction from individual deposits or time deposits. The depositor may be indebted to the bank for money borrowed but no offset is allowed on account of such indebtedness.

(b) Government deposits are exempt from all reserve requirements under authority of the Act of April 24, 1917, and the total amount of such deposits may be deducted from demand deposits in computing reserve.

(c) In the case of bank deposits, the Act provides -

"In estimating the balances required by this Act, the net difference of amounts due to and from other banks shall be taken as the basis for ascertaining the deposits against which required balances with Federal reserve banks shall be determined. "

This language has heretofore been construed as authorizing member banks to deduct the aggregate amount due from other banks from the aggregate amount due to other banks, and to carry reserve only against the net balance due to other banks.

The circumstances under which this provision was incorporated in the Act, which will be later referred to, clearly indicates that this construction is consistent with the intent of Congress.

In determining the amount due from other banks, it has been customary, for years past, to permit national banks to treat the total amount of items placed in the mail and charged to the account of a correspondent as part of the balance due from such correspondent. In conformity with this custom member banks are still permitted to treat out-of-town items in this way.

In order that items payable in the same city in which the member bank is located may be placed on a parity with items payable elsewhere, member banks are likewise permitted to treat checks on other banks in the same place and exchanges for clearing houses as balances due from other banks, and to deduct the aggregate of such items from the aggregate balance due to other banks. This ruling of the Department seems also to be consistent with the purposes of the Act as indicated by the history of this legislation.

Prior to the Act of May 30, 1908, generally known as the Aldrich-Vreeland Act, no deductions were allowed by statute. In order, however, to afford some relief from the rigid reserve requirements which at that time necessitated the maintenance of a much higher reserve than is required at present, the Department permitted national banks to deduct from liabilities against which reserve must be carried -

- (a) Government deposits.
- (b) Balances due from other banks, including
 - (1) Checks on other banks in the same place;
 - (2) Exchange for clearing houses.
- (c) National bank notes.

It is not entirely clear under what authority these deductions were allowed. National banks, however, were required at that time to maintain a certain reserve against "deposits". The Act was not specific as to what should be treated as deposits and so this language was probably construed to mean deposits which were not offset by assets which could be used for the immediate discharge of such liabilities.

The Aldrich-Vreeland Act ratified in effect the ruling of the Department in so far as it related to Government deposits. The Act expired by limitation on June 30, 1916, but the Act of April 24, 1917, above referred to, re-enacted the provisions exempting Government deposits from reserve requirements.

The Federal Reserve Act specifically authorizes the deduction of balances due from other banks.

This office is advised of no other provision of law authorizing any deduction from the amount against which reserve must be carried by member banks and no discretion is vested either in the Federal Reserve Board or the Comptroller of the Currency to permit such deductions.

Without passing upon the question whether or not the deductions allowed prior to the passage of the Federal Reserve Act were justified, it seems clear that since Congress has specifically defined deposits against which reserve must be carried, and has specifically authorized certain deductions to be made, there is no present justification for reading into the Act any intention on the part of Congress to allow other deductions not specifically mentioned.

Notwithstanding the liberal interpretation that has been placed upon the Act in defining balances due from other banks, it has been claimed that the amount against which reserve must be carried should be still further reduced -

(a) By permitting checks on other banks in the same place and exchanges for clearing houses to be deducted from gross demand deposits rather than from balances due to other banks.

(b) By permitting cash on hand to be deducted from gross demand deposits.

The argument advances in favor of the allowance of these deductions should, in the opinion of this office, have been addressed to Congress rather than to the Federal Reserve Board or the Comptroller of the Currency. As above stated, neither the Federal Reserve Board nor the Comptroller are vested with any discretion to permit deductions not specifically authorized by the Act and could not, in the opinion of this office, justify a ruling that banks might deduct cash or other items from their gross demand deposits in computing their reserve.

Respectfully,

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