FEDERAL RESERVE BOARD

WASHINGTON

December 8, 1922.

X-3579.

SUBJECT: Penalties for Deficiencies in Reserves of Member Banks.

Dear Sir:

An examination of the files of the Federal Reserve Board indicates that there is lack of uniformity in the manner in which penalties are assessed on deficiencies in reserves of member banks by the eight Federal Reserve Banks which have adopted progressive penalty rates. With a view of bringing about uniformity of practice in the application of penalty rates, the Board has approved the rules indicated below, which will become effective as of January 1, 1923.

While the Federal Reserve Board is not disposed to rule that progressive penalty rates shall be applied in all districts, preferring, for the time being at least, to leave the matter to the judgment of the board of directors of each bank, it believes that unless it can be shown that the application of a flat penalty rate of 2% above the discount rate on ninety-day commercial paper is as effective as would be the application of progressive penalty rates, the progressive penalty rate plan should be adopted.

RULES GOVERNING APPLICATION OF PENALTY RATES

1. Deficiencies in reserve balances of member banks in central reserve and reserve cities will be computed on the basis of average daily net deposit balances covering a weekly period of 7 days. Deficiencies in reserve balances of country banks will be computed on the basis of average daily net deposit balances covering a semi-monthly period.

2. Penalties for deficiencies in reserves will be assessed monthly on the basis of average daily deficiencies during each of the reserve computation periods ending in the preceding month.

3. A basic rate of 2 per cent per annum above the Federal

Reserve Bank discount rate on 90-day commercial paper will be assessed as a penalty on deficiencies in reserves of member banks.

4. When a member bank in a central reserve or reserve city has had an average deficiency in reserves for six consecutive weekly periods, a progressive penalty, increasing at the rate of 1/4 of1 per cent for each week thereafter during which the average reserve balance is deficient, will be assessed on weekly deficiencies until the required reserve has been restored and maintained for four consecutive weekly periods, provided that the maximum penalty charged will not exceed 10 per cent.

5. When a member bank outside of a central reserve or reserve city has had an average deficiency in reserves for three consecutive semi-monthly periods, a progressive penalty, increasing at the rate of 1/2 of 1 per cent for each half-month thereafter during which the average reserve balance is deficient, will be assessed on semi-monthly deficiencies until the required reserve has been restored and maintained for two consecutive semi-monthly periods, provided that the maximum penalty charged will not exceed 10 per cent.

Member banks in central reserve or reserve cities which have beendeficient in reserves for six consecutive weeks, and member banks outside of central reserve or reserve cities which have been deficient in reserves for three consecutive semi-monthly periods, should be promptly advised that their reserves have been continuously below requirements for an undue period. Federal Reserve Banks which apply progressive penalty rates should also call the attention of such banks to the fact that unless reserves are restored and maintained as required by law progressive penalty rates will be assessed.

The Board's letter St. 3057 of September 26, 1922, authorized the discontinuance of detailed reports called for in its letter X-3040 of February 4, 1921. In order, however, that the Board may be advised in regard to any member bank that persistently fails to maintain its legally required reserve, it is requested that a quarterly report be submitted by each Federal Reserve Bank covering only those banks against which the maximum progressive rate of 10 per cent has been assessed or would be assessed under the above rules if progressive penalty rates were in force. The reports submitted to the Comptroller of the Currency and the Chief National Bank Examiner should relate only to National Banks, while the report to the Federal Reserve Board should cover all member banks. A copy of that part of the report relating to State banks and trust companies should be submitted to the appropriate State Banking Department calling attention to the fact that the State banks and trust companies in question have been persistently deficient in their legally required reserves.

By order of the Federal Reserve Board.

Very truly yours,

WM. W. HOXTON,
Secretary.

Letter to be sent to
Chairman at each Federal Reserve Bank.