

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

March 8, 1924.
X-3989

Subject: Proposed Regulation J, Series of 1924.

Dear Sir:-

The Federal Reserve Board is now considering the promulgation of a new regulation J to take the place of Regulation J, Series of 1920, which is now in effect. There is enclosed herewith a copy of the proposed new regulation in the form tentatively adopted by the Board.

Before finally adopting this new regulation, the Board desires to have the benefit of your comments thereon and any recommendations you may have to make. You appreciate, of course, the desirability of the Board issuing a new regulation at the earliest possible date, particularly in view of the recent decision of the Supreme Court of the United States in the case of the Federal Reserve Bank of Richmond vs. Malloy Brothers, and it is respectfully requested, therefore, that you advise the Board at your earliest convenience of any suggestions you may desire to make.

Very truly yours,

Walter L. Eddy,
Secretary.

TO GOVERNORS & AGENTS OF ALL FEDERAL RESERVE BANKS.

PROPOSED REGULATION J.
Series of 1924
(Superseding Regulation J of 1920)

X-3989-a

CHECK CLEARING AND COLLECTION.

SECTION I. STATUTORY PROVISIONS.

Section 16 of the Federal Reserve Act authorizes the Federal Reserve Board to require each Federal Reserve Bank to exercise the functions of a clearing house for its member banks, and Section 13 of the Federal Reserve Act, as amended by the act approved June 21, 1917, authorizes each Federal Reserve Bank to receive from any nonmember bank or trust company, solely for the purposes of exchange or of collection, deposits of current funds in lawful money, national-bank notes, Federal reserve notes, checks and drafts payable upon presentation, or maturing notes and bills, provided such nonmember bank or trust company maintains with its Federal Reserve Bank a balance sufficient to offset the items in transit held for its account by the Federal Reserve Bank.

SECTION II. GENERAL REQUIREMENTS.

In pursuance of the authority vested in it under these provisions of law, the Federal Reserve Board, desiring to afford both to the public and to the various banks of the country a direct, expeditious, and economical system of check collection and settlement of balances, has arranged to have each Federal Reserve Bank exercise the functions of a clearing house for such of its member banks as desire to avail themselves of its privileges and for such nonmember State banks and trust companies as may maintain with the Federal Reserve Bank balances sufficient to qualify them under the provisions of section 13 to send items to Federal Reserve Banks for purposes of exchange or of collection. Such nonmember State banks and trust companies will hereinafter be referred to as nonmember clearing banks.

Each Federal Reserve Bank shall exercise the functions of a clearing house under the general terms and conditions hereinafter set forth.

SECTION III. CHECKS RECEIVED FOR COLLECTION.

(a) Each Federal Reserve Bank will receive at par from its member banks and from nonmember clearing banks in its district, checks¹ drawn on all member and nonmember clearing banks, and checks drawn on all other nonmember banks which are collectable at par in funds acceptable to the Federal Reserve Bank of the district in which such nonmember banks are located.

(b) Each Federal Reserve Bank will receive at par from other Federal Reserve Banks, and from all member and nonmember clearing banks in other Federal Reserve districts authorized to route direct for the credit of their accounts with their respective Federal Reserve Banks, checks drawn on all member and nonmember clearing banks of its district, and checks drawn on all other nonmember banks of its district which are collectable at par in funds acceptable to it.

(c) No Federal Reserve Bank shall receive on deposit or for collection any check drawn on any nonmember bank which cannot be collected at par in funds acceptable to the Federal Reserve Bank.

SECTION IV. TIME SCHEDULE AND AVAILABILITY OF CREDITS.

Each Federal Reserve Bank will publish a time schedule showing the time at which any item sent to it will be counted as reserve and become available to meet checks drawn. For all checks received, the sending bank will be given immediate credit, or deferred credit, in accordance with such time schedule, and as provided below.

For all such checks as are received for immediate credit in accordance with such time schedule, immediate credit, subject to final payment, will be given upon the books of the Federal Reserve Bank at full face value in the reserve account or clearing account upon day of receipt, and the proceeds will at once be counted as reserve and become available to meet checks drawn.

For all such checks as are received for deferred credit in accordance with such time schedule, deferred credit, subject to final payment, will be entered upon the books of the Federal Reserve Bank at full face value, but the proceeds will not be counted as re-

¹A check is generally defined as a draft or order upon a bank or banking house, purporting to be drawn upon a deposit of funds, for the payment at all events of a certain sum of money to a certain person therein named, or to him or his order, or to bearer, and payable on demand.

serve nor become available to meet checks drawn until such time as may be specified in such time schedule, at which time credit will be transferred from the deferred account to the reserve account or clearing account and will then be counted as reserve and become available to meet checks drawn.

SECTION V. MANNER OF COLLECTION.

The Federal Reserve Board hereby authorizes, and each member and nonmember clearing bank will be required to authorize, the Federal Reserve Banks to handle checks received on deposit or for collection as follows:

(1) A Federal Reserve Bank will act as agent only and will assume no liability except for its own negligence and its guaranty of prior indorsements.

(2) A Federal Reserve Bank is authorized to present or send checks for payment in cash or exchange draft direct to the bank on which they are drawn or at which they are payable, or in its discretion to forward them to another Agent with authority to present or send them for payment in cash or exchange draft direct to the bank on which they are drawn or at which they are payable.

(3) Checks received by a Federal Reserve Bank on its member or nonmember clearing banks will be forwarded or presented direct to such banks, and such banks will be required to remit therefor at par in funds acceptable to the Federal Reserve Bank, or to authorize the Federal Reserve Bank to charge their reserve accounts or clearing accounts; provided, however, that the Federal Reserve Bank reserves the right to charge such items to the reserve account or clearing account of such bank at any time when the Federal Reserve Bank deems it necessary to do so.

(4) Checks received by a Federal Reserve Bank payable in other districts will be forwarded to the Federal Reserve Bank of the district in which such items are payable.

(5) A Federal Reserve Bank will charge back the amount of any check for which payment either in cash or in the proceeds of an exchange draft has not actually been received, regardless of whether or not the check itself can be returned.

SECTION VI. PENALTIES FOR DEFICIENCIES IN RESERVES.

(a) Statutory provisions. - Section 19 of the Federal Reserve Act provides that -

The required balance 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 balance required by law is fully restored.

(b) Computation of reserves.- Items can not be counted as part of the minimum reserve balance to be carried by a member bank with its Federal Reserve Bank until such time as may be specified in the appropriate time schedule referred to in Section IV. If a member bank draw against items before such time, the draft will be charged against its reserve balance if such balance be sufficient in amount to pay it; but any resulting impairment of reserve balances will be subject to all the penalties provided by the Act.

(c) Basic penalty.- Inasmuch as it is essential that the law in respect to the maintenance by member banks of the required minimum reserve balance shall be strictly complied with, the Federal Reserve Board, under authority vested in it by section 19 of the Federal Reserve Act, hereby prescribes a basic penalty for deficiencies in reserves according to the following rules:

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 seven days. Deficiencies in reserve balances of other member banks will be computed on the basis of average daily net deposit balances covering a semimonthly 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.

(d) Progressive penalty. - The Federal Reserve Board will also prescribe for any Federal Reserve District, upon the application of the Federal Reserve Bank of that district, an additional progressive penalty for continued deficiencies in reserves, in accordance with the following rules:

1. 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 one-fourth of 1 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.

2. When a member bank outside of a central reserve or reserve city has had an average deficiency in reserves for three consecutive semimonthly periods, a progressive penalty, increasing at the rate of one-half 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 semimonthly periods, provided that the maximum penalty charged will not exceed 10 per cent.

SECTION VII. OTHER RULES AND REGULATIONS.

Any further requirements that the Board may deem necessary will be set forth by the Federal Reserve Banks in their letters of instruction to their member and nonmember clearing banks. Each Federal Reserve Bank will also promulgate rules and regulations governing the details of its operations as a clearing house, such rules and regulations to be binding upon all member and nonmember banks which are clearing through the Federal Reserve Bank.

PROPOSED AMENDMENTS TO REGULATION H, SERIES OF 1923.
(Revised Draft)

A. In the fourth line of the last paragraph of Section III, strike out the words "to insure compliance with the act and these regulations," and insert a period after the word "necessary."

B. Change Section IV to Section VII; strike out the word "and" in the third line of said section; insert a comma after the word "Act;" change the semicolon at the end of subdivision 1 of said section to a comma; and add the following at the end of said subdivision 1:

"and the conditions prescribed by the Federal Reserve Board and agreed to by such State bank or trust company prior to its admission."

C. Change Section V to VIII.

D. Insert the following new sections immediately after Section III:

SECTION IV. CONDITIONS OF MEMBERSHIP.

Pursuant to the authority contained in the first paragraph of Section 9 of the Federal Reserve Act, which provides that the Federal Reserve Board may permit applying banks to become members of the Federal Reserve System "subject to such conditions as it may prescribe", the Federal Reserve Board will prescribe the following conditions of membership for each bank or trust company hereafter applying for admission to the Federal Reserve System, in addition to such other conditions as the Board may consider necessary or advisable in the particular case -

1. Except with the permission of the Federal Reserve Board, such bank or trust company shall not cause or permit any change to be made in the general character of its assets or in the scope of the functions exercised by it at the time of admission to membership, such as will tend to affect materially the standard maintained at the time of its admission to the Federal Reserve System

and required as a condition of membership.

2. Such bank or trust company shall at all times conduct its business and exercise its powers with due regard to the safety of its customers.

3. Such bank or trust company shall not reduce its capital stock except with the permission of the Federal Reserve Board.

4. Such bank or trust company shall not, except after applying for and receiving the permission of the Federal Reserve Board, establish any branch, agency or additional office.

5. Such bank or trust company shall not, except after applying for and receiving the permission of the Federal Reserve Board, consolidate with or absorb any other bank or branch bank; nor directly or indirectly, through affiliated corporations or otherwise, acquire an interest in another bank in excess of 20 per cent of the capital stock of such other bank; nor directly or indirectly promote the establishment of any new bank for the purpose of acquiring such an interest in it; nor make any arrangement to acquire such an interest.

6. Such bank or trust company shall reduce to, and maintain within, the limits prescribed by the laws of the State in which it is located, any loan which may be in excess of such limits.

7. Such bank or trust company shall reduce to an amount equal to 10 per cent of its capital and surplus all balances in excess thereof, if any, which are carried with banks or trust companies which are not members of the Federal Reserve System, and shall at all times maintain such balances within such limits.

8. Such bank or trust company may accept drafts and bills of exchange drawn upon it of any character permitted by the laws of the State of its incorporation; but the aggregate amount of all acceptances outstanding at any

one time shall not exceed the limitations imposed by Section 13 of the Federal Reserve Act, that is, the aggregate amount of acceptances outstanding at any one time which are drawn for the purpose of furnishing dollar exchange in countries specified by the Federal Reserve Board shall not exceed 50 per cent of its capital and surplus, and the aggregate amount of all other acceptances, whether domestic or foreign, outstanding at any one time shall not exceed 50 per cent of its capital and surplus, except that the Federal Reserve Board, upon the application of such bank or trust company, may increase this limit from 50 per cent to 100 per cent of its capital and surplus:

Provided, however, that in no event shall the aggregate amount of domestic acceptances outstanding at any one time exceed 50 per cent of the capital and surplus of such bank or trust company.

9. The Board of directors of said bank or trust company shall adopt a resolution authorizing the interchange of reports and information between the Federal Reserve Bank of the district in which such bank or trust company is located and the banking authorities of the State in which such bank is located.

Each bank or trust company applying for membership hereafter will be required to agree to the above conditions and any other conditions which the Board may prescribe, prior to the admission of such bank or trust company to the Federal Reserve System.

SECTION V. CHANGES IN ASSETS OR BROADENING OF FUNCTIONS.

Each bank or trust company hereafter admitted to the Federal Reserve System and each bank or trust company which has heretofore been admitted subject to Condition No. 1 of Section IV or subject to any similar condition, shall, before opening any new department, consolidating or merging with any

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other bank, purchasing the assets of any other bank or trust company, establishing any branch, agency or additional office, or taking any other steps which may result in a change in the general character of its assets or broadening in the functions exercised by it, notify the Federal Reserve Board of its intention to take such action in order that the Federal Reserve Board may make an examination or take such other steps as it may consider necessary to ascertain whether such action will tend to affect materially the standard maintained by such bank at the time of its admission and required as a condition of membership.

SECTION VI. PRINCIPLES GOVERNING ESTABLISHMENT OF BRANCHES.

In passing upon applications by State banks and trust companies for permission to establish branches, agencies or additional offices, under Condition No. 4 of Section IV, or under any similar condition which may have been prescribed by the Federal Reserve Board and agreed to by any bank or trust company heretofore admitted to the Federal Reserve System, the Federal Reserve Board will observe the following principles -

1. The Federal Reserve Board will restrict the establishment of branches, agencies or additional offices by such banks or trust companies to the corporate limits of the city or town in which the parent bank is located and to such territory as is contiguous to such place or location of the parent bank or head office as the term "contiguous territory" is now defined by the Federal Reserve Board or as it may hereafter be defined. ¹

2. The Federal Reserve Board will not consider an application by such bank or trust company for a permit to establish a branch, agency, or additional office, unless the authorities of the State in which such bank is located regularly make simultaneous examinations of the head office and all branches, agencies or additional offices of such bank, ^{OR} ~~nor~~ unless the examinations made by the State authorities are, in the judgment of the Federal Reserve Board, of such character in every respect as to furnish the Federal Reserve Board with sufficient information as to the condition of such bank and the character of its management to enable it fully to protect the interests of the public.

1. The term "contiguous territory" is defined by the Board to mean: "The territory of a city or town whose corporate limits at some point coincide with the corporate limits of the city or town in which the parent bank is located." This definition has been amended in the case of Los Angeles and San Francisco, California, by a more specific definition which is effective until August 1, 1924.

3. The Federal Reserve Board will require each bank or trust company which establishes or maintains branches, agencies or additional offices to maintain for itself and such branches, agencies or additional offices an adequate ratio of capital to total liabilities and an adequate percentage of its total investments in the form of paper or securities eligible for discount or purchase by Federal reserve banks.

4. The Federal Reserve Board will not consider any application to establish a branch, agency or additional office until the establishment of such branch, agency or additional office has been approved by the Banking authorities of the State in which such bank or trust company is located and such authorities have certified that, (1) the applying bank or trust company is solvent and is not in a dangerous or extended condition and (2) the character of its management is such as to justify the establishment of such branch, agency or additional office; nor until the Directors or Executive Committee and the Federal Reserve Agent of the Federal Reserve Bank of the District in which such bank or trust company is located have submitted a report on these facts and a recommendation as to whether or not the application should be granted.

5. Before permitting such bank or trust company to establish any branch, agency, or additional office, the Federal Reserve Board will require the Federal Reserve Agent of the district in which such bank is located to make an investigation and report whether in his opinion the establishment of such branch, agency, or additional office would be in the interest of the public in the locality in which it is to be established and whether it would endanger the existence of existing local unit banks.

6. When permission is granted for the establishment of such branch,

agency or additional office same shall be established and opened for business within six months after such permission is granted. If such branch, agency, or additional office is not established within such time the permit shall become void, unless the time is extended by the Board for good cause.

7. The Federal Reserve Board reserves the right to cancel any permit which it has granted to establish any branch, agency or additional office whenever in its judgment the bank operating such branch, agency or additional office has engaged in unfair competition or other unfair practices to the detriment of other banks or of the public, or has failed adequately to serve the public interest in the community in which it is located.