

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-6892

May 14, 1931.

SUBJECT: Progressive Penalties on Deficient Reserves.

Dear Sir:

The attached memorandum, addressed to the Governor of the Federal Reserve Board by the Chief of the Division of Bank Operations, on the subject "Progressive Penalties on Deficient Reserves of Member Banks" was read to the recent Conference of Governors which requested that the Federal Reserve Board forward a copy to each Federal reserve bank which now applies progressive penalties for continued deficiencies in reserves. It is being forwarded to the other Federal reserve banks as a matter of information.

The suggestion has been made that the Federal Reserve Board amend its Regulation D, so as either (a) to abolish the progressive penalty altogether, or (b) to make it mandatory and applicable uniformly to all Federal reserve districts. Accordingly, the Board has requested the System Committee on Reserves to make a special study and report as to the effectiveness and desirability of assessing progressive penalties.

Very truly yours,

E. M. McClelland,
Assistant Secretary.

Enclosures.

TO GOVERNORS OF ALL F. R. BANKS.

continued deficiencies, than do the reserve banks that do not apply progressive penalty rates. This raises the question whether the progressive penalties are paid by

- (a) Member banks which, owing to their overextended condition, are unable to maintain their required reserves, or
- (b) Member banks which are in a reasonably satisfactory condition but, through negligence or otherwise, make no attempt to maintain their required reserves.

The Federal Reserve Banks of Chicago, Minneapolis and Dallas, which at one time applied progressive rates, have discontinued them. The reasons given for discontinuing the progressive penalties are as follows:

Governor Young of Minneapolis - "After a thorough investigation of the situation, we are convinced that the banks that pay a ten per cent penalty rate do not do so because of their unwillingness to carry sufficient reserve with us, but solely because of their utter inability to do so."

Mr. Walsh of Dallas - "The progressive rate does not in itself act as a deterrent to member banks, and those banks that have paid the increased rate, even to the maximum, although having every desire to do so, have been unable to maintain their required reserve by reason of having reached their maximum ability."

Mr. Heath of Chicago - "Our observation is that by far the greater number of member banks whose reserves are continually deficient, are unable to maintain such reserves without rediscounting further, and that their condition as a rule is not such as to justify further increase in rediscounts."

Data available in this office indicate that during the past two years, 286 member banks have been subject to the maximum penalty rates of 10 per cent, or would have been subject to such rates had they been applied in all districts. Of these 286 banks, 163 are still members, 79 have suspended, 29 have been absorbed by other banks, 8 have been reorganized or succeeded by new banks, 6 have withdrawn from the System, and 1 has gone into voluntary liquidation.

The fact that Federal reserve banks that apply progressive penalties have relatively more member banks with continued deficiencies than Federal reserve banks that do not apply progressive penalties, and that a relatively large percentage of the member banks that pay the progressive penalties are in an overextended condition, raises the question as to whether the application of progressive penalties does not, in most cases, place additional burdens on those member banks which are least able to bear them.

It occurs to me that you may wish to discuss this question with the Governors at their conference next week.

DEFICIENCIES IN RESERVES OF MEMBER BANKS DURING 1930

B-324

Federal Reserve District	Average number of member banks in district	Average number of banks subject to penalties for deficient reserves				Number of banks, out of each 1000 in operation, that were --				Average daily reserves of all member banks	Average daily deficiencies	Ratio of average deficiencies to average reserves of all member banks
		Total	At maximum rate of 10 per cent*	At lower progressive rates*	At normal rate	Deficient in reserves (total)	Subject to maximum penalty of 10%	Subject to lower progressive penalties	Subject to normal penalty			
F.R. BANKS THAT APPLY PROGRESSIVE PENALTIES										(In thousands of dollars)		
Boston	400	60	-	4	56	150	-	10	140	147,066	125	.085%
Philadelphia	756	110	-	5	105	146	-	7	139	137,819	153	.111
Cleveland	783	124	3	19	103	158	4	24	132	191,745	386	.201
San Francisco	594	139	1	10	128	234	2	17	215	175,653	123	.070
Richmond	492	160	10	26	125	325	20	53	254	63,713	375	.589
Atlanta	411	136	16	21	99	331	39	51	241	61,648	355	.576
Kansas City	885	158	5	14	138	179	6	16	156	87,741	171	.195
Total	4,321	887	35	99	754	205	8	23	175	865,385	1,688	.195
F.R. BANKS THAT DO NOT APPLY PROGRESSIVE PENALTIES												
New York	923	237	-	4	233	257	-	4	252	981,690	476	.048
Chicago	1,132	238	9	24	206	210	8	21	182	344,423	574	.167
St. Louis	548	198	5	16	177	361	9	29	323	76,220	287	.377
Minneapolis	662	114	6	18	91	172	9	27	138	51,086	126	.247
Dallas	716	128	5	16	106	179	7	22	148	60,289	245	.406
Total	3,981	915	25	78	813	230	6	20	204	1,513,708	1,708	.113

*For the last five districts, columns 3 and 4 represent the member banks which would have been subject to progressive rates if such rates had been applied by the respective Federal reserve banks. In the Atlanta district the maximum rate is 8 per cent.

NOTE: Total number of member banks, as shown in column 1, is the average of 12 end-of-month dates; the number of banks deficient in reserves is the average of quarterly reports; daily deficiencies are also averages of quarterly reports.

FEDERAL RESERVE BOARD
 DIVISION OF BANK OPERATIONS
 APRIL 24, 1931