FEDERAL RESERVE SYSTEM

The Federal Reserve System was established pursuant to authority contained in the Act of December 23, 1913, known as the Federal Reserve Act, the purposes of which, as stated in the preamble, are "To provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes." The System comprises the Federal Reserve Board, which exercises supervisory functions, the Federal Advisory Council, which acts in an advisory capacity to the Federal Reserve Board, the twelve Federal reserve banks situated in different sections of the United States, and the member banks, which include all national banks and such State banks and trust companies as have voluntarily applied to the Federal Reserve Board for membership and have been admitted to the System.

The Federal reserve banks are located in Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas and San Francisco. There are also in operation twenty-five branches and two agencies of the Federal reserve banks, all of which are located in other cities of the United States, except one agency in Havana, Cuba.

The capital stock of the Federal reserve banks is entirely owned by the member banks and may not be transferred or hypothecated. Every national bank in existence at the time of the establishment of the Federal Reserve System was required to subscribe to the capital stock of the Federal reserve bank of its district in an amount equal to six per cent of the subscribing bank's capital and surplus. A like amount of Federal reserve bank stock must be subscribed for by every national bank organized since that time and by every State bank or trust company upon becoming a member of the Federal Reserve System; and, when a member bank increases its capital or surplus, it is required to subscribe for additional stock in the same proportion. One half of each subscription must be fully paid and the remainder is subject to call by the Federal Reserve Board; but call for payment of the remainder has never been made.

After all necessary expenses of a Federal reserve bank have been paid or provided for, the stockholding member banks are entitled to receive an annual dividend of six per cent on the paid-in capital stock, which dividend is cumulative. After these dividend claims have been fully met, the net earnings are paid into a surplus fund, until it amounts to 100 per cent of the subscribed capital of the bank. Thereafter 10 per cent of such earnings is paid into the surplus, and the remaining net earnings are paid to the United States as a franchise tax. Federal reserve banks, including the capital stock and surplus therein and the income derived therefrom, are exempt from Federal, State and local taxation, except taxes upon real estate.

The board of directors of each Federal reserve bank is composed of nine members, equally divided into three classes, designated Class A, Class B and Class C. Directors of Class A are representative of the stockholding member banks. Directors of Class B must be actively engaged in their district in commerce, agriculture or some other industrial pursuit, and may not be officers, directors or employees of any bank. Class C directors may not be officers, directors, employees, or stockholders of any bank. Six of the nine directors, those of Class A and Class B, are elected by the stockholding member banks, while the Federal Reserve Board appoints the three Class C directors. The term of office of each director is three years, so arranged that the term of one director of each class expires each year.

One of the Class C directors appointed by the Board is designated as chairman of the board of directors of the Federal reserve bank and as Federal reserve agent, and in the latter capacity he is required to maintain a local office of the Federal Reserve Board on the premises of the Federal reserve bank. Another Class C director is appointed by the Federal Reserve Board as deputy chairman.

Federal reserve banks are authorized, among other things, to discount for their member banks notes, drafts, bills of exchange and bankers' acceptances of short maturities arising out of commercial and agricultural transactions, and short term paper secured by obligations of the United States; to make advances to their member banks for periods not exceeding fifteen days upon collateral security of certain prescribed classes; in certain exceptional circumstances and under certain prescribed conditions, when authorized by at least five members of the Federal Reserve Board, to make advances to groups of member banks (and until March 3, 1933, to individual member banks) upon other kinds of security; in unusual and exigent circumstances when authority has been granted by at least five members of the Federal Reserve Board, to discount for individuals, partnerships or corporations, under certain prescribed conditions, notes, drafts and bills of exchange of the kinds and maturities made eligible for discount for member banks; to purchase and sell in the open market bankers' acceptances and bills of exchange of the kinds and maturities eligible for discount, and obligations of the United States; to deal in gold coin and bullion; to receive and hold on deposit the reserve balances of member banks; to issue Federal reserve notes; to act as clearing houses and as collecting agents for their member banks, and under certain conditions for nonmember banks, in the collection of checks and other instruments; to act as depositaries and fiscal agents of the United States; and to exercise other banking functions specified in the Federal Reserve Act.

Federal reserve notes are a first and paramount lien on all the assets of the Federal reserve banks through which they are issued and are also obligations of the United States. They constitute at present nearly one half of the total money in actual circulation in the United States outside of the Treasury Department and the Federal reserve banks. They are issued against the security of gold and of commercial and agricultural paper discounted or purchased by Federal reserve banks, and until March 3, 1933, when authorized by the Federal Reserve Board, may also be secured by direct obligations of the United States. Every Federal reserve bank is required to maintain reserves in gold of not less than 40 per cent against its Federal reserve notes in actual circulation and is also required to maintain reserves in gold or lawful money of not less than 35 per cent against its deposits.

Broad supervisory powers are vested in the Federal Reserve Board, which has its offices in Washington. The law designates the Secretary of the Treasury and the Comptroller of the Currency as ex-officio members, and

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provides for the appointment of six members by the President with the advice and consent of the Senate. In selecting these six members, the President is required to have a due regard to a fair representation of the financial, agricultural, industrial and commercial interests, and geographical divisions of the country. No two appointive members may be from the same Federal reserve district.

Among the more important duties of the Federal Reserve Board are the review and determination of discount rates charged by the Federal reserve banks on their loans to member banks and the approval or disapproval of the open market operations of the Federal reserve banks. In connection with its supervision of Federal reserve banks the Board is also authorized to make examinations of such banks; to require statements and reports from such banks; to require the establishment or discontinuance of branches of such banks; to supervise the issue and retirement of Federal reserve notes; and to supervise the foreign operations of the Federal reserve banks.

The Federal Reserve Board also passes on the admission of State banks and trust companies to membership in the Federal Reserve System and on the termination of membership of such banks; it has the power to examine member banks either through its own personnel or in cooperation with national and State banking authorities; it receives condition reports from member banks; it passes on applications of national banks for authority to exercise trust powers or to act in fiduciary capacities; it may grant authority to national banks to establish branches in foreign countries or dependencies or insular possessions of the United States, or to invest in the stock of banks or corporations engaged in international or foreign banking; it supervises the organization and activities of corporations organized under

Federal law to engage in international or foreign banking; and it issues permits under the authority granted by the provisions of the Clayton Antitrust Act relating to interlocking bank directorates. Another function of the Board is the operation of the gold settlement fund, by which balances due to and from the various Federal reserve banks arising out of their own transactions or those of their member banks are settled in Washington without physical shipments of gold.

In exercising its supervisory functions over the Federal reserve banks and member banks, the Federal Reserve Board promulgates regulations, pursuant to authority granted by the Federal Reserve Act, governing certain of the above-mentioned activities of Federal reserve banks and member banks. To meet its expenses and to pay the salaries of its members and its employees, the Board makes semi-annual assessments upon the Federal reserve banks in proportion to their capital stock and surplus. Annual reports of the operations of the Board are made to the Speaker of the House of Representatives for the information of Congress as required by law.

The Federal Advisory Council acts in an advisory capacity, conferring with the Federal Reserve Board on general business conditions and making recommendations concerning matters within the Board's jurisdiction and the general affairs of the Federal Reserve System. The Council is composed of twelve members, one from each Federal reserve district being selected annually by the board of directors of the Federal reserve bank of the district. The Council is required to meet in Washington at least four times each year and oftener if called by the Federal Reserve Board.