X-9323
(Superseding X-9153)

FEDERAL RESERVE SYSTEM

The Federal Reserve System was established pursuant to authority contained in the Act of Congress approved 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 Board of Governors of the Federal Reserve System, which exercises supervisory functions, the Federal Advisory Council, which acts in an advisory capacity to the Board of Governors, the Federal Open Market Committee, the twelve Federal reserve banks situated in different sections of the United States, and the member banks, which include all national banks in the United States and such State banks and trust companies as have voluntarily applied to the Board of Governors 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

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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 in the United States 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 paid-up capital and surplus. A like amount of Federal reserve bank stock must be subscribed for by every national bank in the United States organized since that time and by every State bank or trust company (except mutual savings banks) upon becoming a member of the Federal Reserve System; and, when a member bank increases or decreases its capital or surplus, it is required to alter its holdings of Federal reserve bank stock in the same proportion. A mutual savings bank which is admitted to membership in the Federal Reserve System must subscribe for Federal reserve bank stock in an amount equal to six-tenths of one per centum of its total deposit liabilities; and thereafter such subscription must be adjusted semiannually on the same percentage basis. One half of the subscription of each member bank must be fully paid and the remainder is subject to call by the Board of Governors of the Federal Reserve System; but call for payment of the remainder has not been made.

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After all necessary expenses of a Federal reserve bank have been paid or provided for, its 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 the surplus fund of the Federal reserve bank. 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. The six Class A and B directors are elected by the stockholding member banks, while the Board of Governors of the Federal Reserve System 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

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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 Board on the premises of the Federal reserve bank. Another Class C director is appointed by the Board as deputy chairman. After March 1, 1936, each Federal Reserve bank will have as its chief executive officer a President appointed every five years by its board of directors with the approval of the Board of Governors of the Federal Reserve System. There will also be a first vice-president appointed in the same manner and for the same term.

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, industrial or agricultural transactions, and short term paper secured by obligations of the United States; to make advances to their member banks upon their promissory notes for periods not exceeding ninety days upon the security of paper eligible for discount or purchase and for periods not exceeding fifteen days upon the security of obligations of the United States and certain other securities; to make advances upon security satisfactory to the Federal Reserve banks to member banks for periods not exceeding four months at a rate of interest at least one-half of one per cent higher than that applicable to discounts

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and advances of the kinds mentioned above; in certain exceptional circumstances and under certain prescribed conditions, to make advances to groups of member banks; under certain prescribed conditions, to grant credit accommodations to furnish working capital for established industrial or commercial businesses for periods not exceeding five years, either through the medium of financing institutions or, in exceptional circumstances, directly to such businesses, and to make commitments with respect to the granting of such accommodations; in unusual and exigent circumstances when authority has been granted by at least five members of the Board of Governors, 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 make advances to individuals, partnerships or corporations upon their promissory notes secured by direct obligations of the United States for periods not exceeding ninety days; to purchase and sell in the open market bankers' acceptances and bills of exchange of the kinds and maturities eligible for discount, obligations of the United States and certain other securities; to receive and hold on deposit the reserve balances of member banks; to issue Federal reserve notes and Federal reserve bank notes; to act as clearing houses and as collecting agents for their member banks, and under certain conditions for nonmember banks, in the

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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 are issued against the security of gold certificates and of commercial and agricultural paper discounted or purchased by Federal reserve banks, and, until March 3, 1937, when authorized by the Board of Governors may also be secured by direct obligations of the United States. Every Federal reserve bank is required to maintain reserves in gold certificates of not less than forty per cent against its Federal reserve notes in actual circulation and is also required to maintain reserves in gold certificates or lawful money of not less than thirty-five per cent against its deposits.

Federal reserve bank notes are the obligations of the Federal reserve bank procuring them and are redeemable in lawful money of the United States on presentation at the United States Treasury or at the bank of issue. They may be issued against the security of direct obligations of the United States in an amount equal to the face value of such obligations and against the security of notes, drafts, bills of exchange or bankers' acceptances in an amount equal to not more than ninety per

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cent of the estimated value thereof. Each Federal reserve bank must maintain on deposit in the Treasury of the United States in lawful money a redemption fund equal to five per cent of its liability on Federal reserve bank notes in actual circulation, or such other amount as may be required by the Treasurer of the United States with the approval of the Secretary of the Treasury, and is required to pay a tax of one-fourth of one per cent each half year upon the average amount of its Federal reserve bank notes in circulation. No such Federal reserve bank notes may be issued after the President shall have declared by proclamation that the emergency recognized by him in his proclamation of March 6, 1933, has terminated.

Broad supervisory powers are vested in the Board of Governors of the Federal Reserve System which has its offices in Washington. After February 1, 1936, the Board of Governors will be composed of seven members appointed by the President with the advice and consent of the Senate. In selecting these seven members, the President is required to have due regard to a fair representation of the financial, agricultural, industrial and commercial interests, and geographical divisions of the country. No two members may be from the same Federal reserve district.

Among the more important duties of the Board of Governors is the review and determination of discount rates charged

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by the Federal reserve banks on their discounts and advances. After March 1, 1936, each member of the Board of Governors will also be a member of the Federal Open Market Committee whose membership, in addition, will include five representatives of the Federal Reserve banks, each such representative being elected annually by the boards of directors of certain specified Federal Reserve banks. After March 1, 1936, open-market operations of the Federal Reserve banks will be conducted under regulations adopted by the Committee with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country; and no Federal Reserve bank may engage or decline to engage in open-market operations except in accordance with the direction of and regulations adopted by the Committee.

In connection with its supervision of Federal reserve banks the Board of Governors 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 exercise special supervision over all relationships and transactions of the Federal reserve banks with foreign banks or bankers.

For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Board of

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Governors is authorized to regulate the amount of credit that may be initially extended and subsequently maintained on any security (with certain exceptions) registered on a national securities exchange. Certain other powers have been conferred upon the Board which are likewise designed to enable it to prevent an undue diversion of funds into speculative operations.

The Board of Governors 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 and affiliates of member banks; it receives condition reports from State member banks and their affiliates; it limits by regulation the rate of interest which may be paid by member banks on time and savings deposits; it is authorized, in its discretion, to issue voting permits to holding company affiliates of member banks entitling them to vote the stock of such banks at any or all meetings of shareholders of the member bank; it may issue general regulations permitting interlocking relationships in certain circumstances between member banks and organizations dealing in securities or, under the Clayton Antitrust Act, between member banks and other banks; it has the power to remove officers and directors of a member bank for continued violations of law or unsafe or unsound practices in conducting the business of such bank; it may, in its discretion, suspend member banks from the use of the credit

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facilities of the Federal Reserve System, for making undue use of bank credit for speculative purposes or for any other purpose inconsistent with the maintenance of sound credit conditions; it may, within certain limitations and in order to prevent injurious credit expansion or contraction, change the requirements as to reserves to be maintained by member banks against deposits; it passes on applications of State member banks to establish out-of-town branches; 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; and it supervises the organization and activities of corporations organized under Federal law to engage in international or foreign banking. Another function of the Board is the operation of a settlement fund, by which balances due to and from the various Federal reserve banks arising out of their own transactions or transactions of their member banks or of the United States Government are settled in Washington through telegraphic transfer of funds without physical shipments of currency.

In exercising its supervisory functions over the Federal reserve banks and member banks, the Board of Governors

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promulgates regulations, pursuant to authority granted by the law, 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 semiannual assessments upon the Federal reserve banks in proportion to their capital stock and surplus. The Board keeps a complete record of all action taken by it and by the Federal Open Market Committee on any question of policy, and in the annual report which it makes to the Speaker of the House of Representatives for the information of Congress as required by law, it includes a full account of all such action and also a copy of the records required to be kept in that connection.

The Federal Advisory Council acts in an advisory capacity, conferring with the Board of Governors 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 Board of Governors.

September 20, 1935.

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