FEDERAL RESERVE SYSTEM

COMMITTEE ON THE DISCOUNT AND
DISCOUNT RATE MECHANISM

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by A. H. Mills, Jr.
SYSTEM COMMITTEE ON THE DISCOUNT AND DISCOUNT RATE MECHANISM

Report on the Discount Mechanism

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When the Federal Reserve System was founded, the view was generally held that discounting would be the chief means by which Federal Reserve credit would be made available to member banks. The thought was that, when member banks had exhausted their own lending power and there continued to be legitimate productive demands for credit, they would be able to obtain additional reserve funds from the Reserve Banks at the discount rate against the pledge of eligible paper. Since eligible paper by legal definition was to have a self-liquidating quality, it was also thought that member banks in stressing the acquisition of such paper as a means of access to Federal Reserve credit would keep their asset positions liquid and sound.

Four decades of Federal Reserve experience changed substantially the role of discounts in System monetary functions. Experience taught the dangers to sustained banking stability of excessive member bank reliance on borrowed funds and implanted deeply a member bank reluctance to incur and sustain discount debt. It also pointed up that member bank reserves put out through the discount window at once comingle with reserves from every other source, with their use beyond regulation by discount rules, and further that reserves obtained through discounts have the same multiplying power with respect to member bank assets and deposits as reserves obtained from any other source.

Experience, in addition, altered fundamentally the concept of eligibility. This concept changed both in banking theory and in law from a narrow one of the legal eligibility of the paper offered for discount to a broader one including appropriateness of borrowing
as well as the character of the paper discounted. The broader concept placed primary emphasis on the circumstances giving rise to the member bank borrowing from the standpoint of sound credit conditions and the general economic situation.

In four decades of System operation, the discount instrument was reduced from the main reliance of reserve banking control to one of three major tools for influencing member bank lending power. The coordinated use of these instruments thus emerged as the central task of Federal Reserve operations. In applying its policy tools, moreover, the responsibility of the System itself broadened from a technical one of furnishing an elastic currency and providing a discount facility into a national responsibility for regulating the over-all flow of credit and money with a view to orderly economic growth at high levels of activity and employment. These developments made it more essential that the several policy-making bodies in the System's structure--the Board of Governors, the Federal Open Market Committee, and the directors of the twelve Federal Reserve Banks--work closely together in carrying out their respective responsibilities in effectuating System policy.

The assignment made to the Committee on the Discount and Discount Rate Mechanism has been to reassess the System's discount function in the existing credit and monetary environment. The immediate background of the Committee's activities has been a period of transition from virtually unlimited provision of Federal Reserve credit through the open market channel at the call of the market to a flexible provision of bank reserve funds through alternative
channels in accordance with System appraisal of the economy's needs from the standpoint of stability and growth. The longer background of the Committee's study includes two decades during which, for a succession of differing reasons, only slight use was made by member banks of the discount facility.

Reinstitution of flexible credit and monetary policy following the Treasury-Federal Reserve accord in 1951 required a System policy of restraint under the prevailing inflationary conditions, and such a policy called for a reduced availability of bank reserves. Under this restrictive policy, member banks gradually increased their use of the discount facility and, accompanying this increase, the climate or tone of the credit market tightened significantly. The peak of the discount growth occurred toward the close of 1952 and discounts remained high through the winter months. In the spring of 1953, reflecting the force of the member bank tradition against continuing discount debt, some System admonitions in individual bank cases, and the effect of an increase in the discount rate, member banks endeavored to reduce or pay off entirely their borrowings from the Reserve Banks. As a result, credit markets tightened sharply further. This was at a time of overall abatement of inflationary tendencies.

To assure the economy that credit and monetary pressures would not in themselves upset a topping business situation and bring about deflation, the System found it desirable in late spring to supply reserve funds to member banks. This was done by providing through open market operations and a reduction in reserve requirements enough funds to obviate heavy member bank reliance on the discount
facility in meeting seasonal and growth needs for reserves over the remainder of the year. These actions were promptly reflected in further reduction in member bank discounts and in a shift in the climate of the market from one of credit tightness to one of relative ease. Subsequently, as levels of business activity and credit demand showed signs of recession, System policy was actively directed toward credit ease by supplying additional reserves through open market operations and thus keeping member bank borrowing at a low level.

The pattern of use of the discount facility in this episode, with expansion and contraction of credit demands, conformed broadly with that experienced under flexible reserve banking operations in the Twenties. There were important differences, however. Far less use was made of the discount facility in relation to total member bank reserve funds than in the Twenties. The banking system and indeed the whole credit market showed itself more sensitive to the rise in discount debt, considering its relative magnitude as well as the conditions which brought it about, than had been the case in earlier experience.

In the light of this experience the Committee has been concerned with the problem of what norm the System should have in mind with respect to future discount use by member banks. Some conception of a norm, consistent with the maintenance of sound banking conditions, has seemed essential to the framing of the Committee's report.

As a reasonable standard, it seems likely that banks will normally seek to be out of debt to the Federal Reserve and that, consequently, the reserve funds necessary for economic and banking
growth will need to become available through other channels. This means as a norm a relatively small volume of discounts by a shifting number of member banks, with changes in that volume reflecting the temporary response of individual banks to losses or accessions of reserve funds and to the strength of the demands for credit made upon them.

Such a norm further implies that, when demands for bank credit are especially vigorous and System policy is directed at credit restraint, the volume of discounts and the number of banks resorting to discounts will increase—sharply when the strength of credit demands requires that restrictive policy be aggressive. On the other hand, when bank credit demands slacken and System policy is directed at credit ease, the suggested norm assumes that the volume of discounts will decrease—sharply when contraction of credit demands requires that easing policy be active.

Thus, by the Committee’s standard, aggregate use by member banks of the discount facility over the future will reflect to a large extent the degree of pressure on the credit market resulting from the interplay of credit demands and general credit and monetary policy. The discount mechanism in these conditions will complement open market operations and changes in reserve requirements in effectuating Federal Reserve policy directed at economic stability and growth.

The Committee has interpreted its responsibility to be one of raising for System consideration and discussion the pertinent issues with regard to the present-day functioning of the discount mechanism. Its studies point to the desirability of revising Regulation A to make
the Regulation express more adequately and effectively the System's contemporary discount philosophy. At what precise time and under what circumstances a revised Regulation A should be promulgated is a problem in itself, the solution of which deserves careful consideration. In that connection, it should be borne in mind that Regulation A has not been revised since 1937, although the intervening years have seen further evolution of System philosophy.

The reasoning presented in the Committee's report is based on certain premises with respect to the member bank tradition against borrowing, System experience over the years with the discount mechanism, and the implications of successive legislative amendments of the System's discount authority. The Committee recognizes fully the many complexities of the subject matter with which its present report deals and is aware that some objections may be advanced against its reasoning on the basis of different premises, from a different weighting of premises, or on the basis of different judgments as to what is practical operationally. Because of this, the Committee has found it desirable to point out in a later section of the report the principal objections to its suggestions. This treatment stresses further the Committee's role of setting forth clearly the issues which its studies have shown to be important.

The Committee's present report is concerned almost exclusively with the discount process by itself. The Committee has not yet completed its studies of the discount rate mechanism and expects to report on this subject at a subsequent time. In view of the
interconnection between the discount process and the discount rate mechanism, however, the Committee has concluded this report with some tentative general observations concerning the relation of discount regulation to discount rate policy.

Committee Frame of Reference and Procedures

The Board of Governors at its meeting on April 2, 1953, directed the staff in collaboration with the staffs of the Reserve Banks to make a comprehensive study of the System's discount and discount rate mechanism looking toward a fresh appraisal of this important reserve banking function. Upon completion of this study and preliminary discussion of its several parts, the Board on June 9, 1953, authorized the formation of a System Committee to extend the inquiry and make such recommendations for adaptation in the discount mechanism as would seem to be called for in the light of progress over the past two years in reestablishing flexible credit and monetary policy. The Committee was organized in July 1953, composed of one member designated by the Board of Governors as chairman, one member designated by the Chairmen’s Conference, and one member designated by the Presidents' Conference. Thus constituted, the membership of the Committee included:

Abbot L. Mills, Jr. (Board of Governors), Chairman
John S. Coleman (Conference of Chairmen)
Alfred H. Williams (Conference of Presidents)

As the background material for its work, the Committee had available the following analytical and educational memoranda prepared in connection with the earlier authorized research activity:

*These memoranda were circulated to System officials in June 1953 for their information.
In addition, the Committee had access to the replies of the twelve Reserve Banks to an inquiry into their discount procedures and practices conducted by the Board's Division of Bank Operations in April and May 1953. The information provided by this survey covered Reserve Bank organization for handling discounts, director participation in Reserve Bank discount policy and its application, procedures in processing discount applications, considerations weighed in approving or disapproving discounts, procedures followed in keeping Reserve Banks informed as to the character of loans and investments of member banks and whether undue use of bank credit is being made for
speculative purposes, and procedures in discount cases calling for special administrative action. The results of this survey were circulated only to the Board of Governors and the members of this Committee. A synopsis of the replies is included with this report as Appendix A.

On September 9, 1953, the Committee held a full day's discussion of the System's discount and discount rate mechanism with the System's staff participating in preparatory research. On September 10, 1953, the Committee met for a full day's discussion of System discount practices with senior discount officers from each of the Reserve Banks. Against this background of documentation and discussion, the Committee then began its deliberations and the preparation of its own report.

General Considerations Bearing on Use of the Discount Facility

Through the discount window at the Reserve Banks access to Federal Reserve credit is available at the initiative of nearly seven thousand member banks. When the System exerts restraint on credit and monetary expansion and therefore keeps the aggregate volume of bank reserves under tighter control, this provision for direct access to reserves by individual member banks raises difficult problems of discount management. It is desirable, on the one hand, to keep open the privilege of individual member banks to borrow at the Reserve Banks to meet essential temporary or emergency needs. On the other hand, the borrowing facility should not provide a channel through which member banks generally or an important segment of them may be able to avert the over-all credit and monetary objectives of the System.
RestRAINT on the use, or overuse, of the discount facility may be accomplished by making it expensive to borrow or by limiting access to borrowing through rules and customs. The Federal Reserve has always functioned with a combination of these methods, but with experience there has been an evolution in the emphasis placed on them.

Early in System history, member bank discounts were the main channel for the extension of Federal Reserve credit. In regulating use of the discount facility emphasis was first placed on moral suasion as a supplement to the discount rate in deterring excessive individual bank borrowing. In the inflationary boom following World War I when member bank discounts expanded rapidly to a volume substantially greater than member bank reserve balances, it became necessary to rely more particularly on the discount rate. In 1920, in an effort to make effective a policy of credit restraint discount rates were raised sharply at the New York and several other Reserve Banks to as high as 7 per cent. This discount rate action, on top of continuing moral suasion efforts to limit discounts on the part of individual banks, produced intense efforts on the part of the banking system to reduce discount indebtedness. A major lesson brought out by the bank credit liquidation which ensued was that it was unsound for any member bank to use continuous indebtedness to its Reserve Bank as a resource for conducting regular banking operations.

Through the Twenties, Reserve Bank lending continued as an important source of bank reserves, although, because of the availability of funds from other sources, not as important a source as in the preceding war and postwar period. Nevertheless, a number of member
banks that were expanding aggressively supplemented their resources more or less continuously with discount credit. In the late Twenties, when demands for stock market and other credit were heavy, Reserve Bank discounts rose to nearly two-fifths of member bank reserves and an increased number of banks became a continuous borrowing problem. Both discount rate and moral suasion action were used by the System in this period in attempting to deal with excessive reliance on the discount facility by many member banks.

In the severe banking crisis and liquidation in the early Thirties, adjustment problems of the aggressive, continuous borrowing banks made evident the hazards to safety of depositor funds and the dangers to bank solvency resulting from the injection between bank capital and deposits of borrowed funds having a creditor status ahead of deposit liabilities. The experience of these banks focused business and financial attention on the fundamental unsoundness of undue dependence of individual member banks on indebtedness to the Reserve Banks. The experience proved to that generation of bankers and depositors that, for more or less permanent adjustments in its operating position, a member bank should rely on shifts in the composition and size of its assets, and that its recourse to the Federal Reserve Bank discount window should be only for temporary adjustments in its reserve position. Because of this costly lesson, it was possible by the mid-Thirties to speak of an established tradition against member bank reliance on the discount facility as a supplement to its resources.
In a banking organization made up of thousands of member banks engaged in widely differing kinds of banking business, a well entrenched tradition against commercial bank reliance on borrowed funds is an important aid to reserve banking. It helps both to make reserve banking operations effective and to preserve a strong and responsive system of individual banks.

From the standpoint of effective reserve banking operations, such a tradition permits the discount facility to serve as a safety valve, easing temporarily the special reserve pressures on individual banks. At the same time, it prevents that facility from becoming a gaping hole through which are released all of the pressures on bank reserves built up within the banking system as a whole. Reluctance to borrow, moreover, can serve to relieve strain on the discount rate and quicken banking response to credit and monetary policy directed at restraint. Providing that excessive reliance on the discount window has been avoided during prosperity, the tradition need be little, if any, handicap to reserve banking operations directed to credit and monetary ease, when other instruments of policy are being actively used to take member banks generally out of debt and to raise the liquidity of the banking system as a whole.

From the standpoint of strong and responsive banking conditions, the tradition against borrowing in long periods of economic prosperity helps to prevent the more aggressive member banks from building up undue dependence on discount credit. Chronically indebted banks risk depositor pressure in the event that economic conditions turn adverse and the fact of their difficulties in a closely
interdependent banking community can make other banks, even those in a strong position, highly sensitive about their own liquidity needs. This kind of banking climate can set the stage for a period of irrational bank credit liquidation. As Federal Reserve experience in at least one important period illustrates, constructive credit and monetary policy to cushion economic recession and foster revival can be rendered substantially ineffectual by persistent dependence on the discount facility developed by some banks in a prior phase of economic boom.

The Committee believes that the tradition against continuous member bank dependence on the discount facility is sound in principle and proven by four decades of Federal Reserve experience. Future discount policy, in its opinion, should build on the tradition as a keystone.

Major Findings and Suggestions

Regulation A

The Committee's major conclusion is that a gearing of the System's discount mechanism to present-day banking and monetary conditions needs as a basic step reconsideration of the philosophy underlying the Board's Regulation A. The present regulation, while it conforms to the requirements of Federal Reserve law as amended over the years, carries forward an accent relating back to the banking-school theory of commercial banking and reserve banking, namely, that commercial bank assets and Reserve Bank discount assets should be comprised primarily of self-liquidating paper. The banking-school philosophy has been rendered obsolete by banking events, changes
in banking practice, and developments in banking theory, which in turn influenced successive amendments to the Federal Reserve Act. If the System is to support adequately through its discount rules the member bank tradition against large and continuous borrowing and if it is to carry out its credit and monetary responsibilities as they are now recognized, its discount regulation needs to be adapted more closely to contemporary economic thought and to embody more definitely the principles applicable to Reserve Bank lending that are expressed or implicit in existing statutes.

Background of the Present Regulation.--The present Regulation A was last revised in 1937. This revision took account of amendments made to the law by the Banking Acts of 1933 and 1935 in the light of the then existing climate of opinion. Developments in discount operations since that time have brought out that the Regulation places disproportionate emphasis on eligibility in the narrower sense of that term and does not bring out adequately that successive amendments of the Federal Reserve Act have built into banking law a major change in discount philosophy.

The philosophy of the discount function in the original Federal Reserve Act was based on the concept that reserve banking operations would be soundly conducted if discounts and advances were confined to paper meeting certain specific tests as to eligibility and if Federal Reserve note issues were secured partly by such paper and partly by gold. Eligible paper under the commonly accepted banking principle of that time was considered to be short-term paper arising
out of specific commercial, industrial, and agricultural transac-
tions which in and of themselves would provide the resources for the
liquidation of the loan.

Linking the supply of bank reserves and issues of Federal
Reserve notes to eligible commercial paper was supposed to make the
total money supply automatically responsive to fluctuations, seasonal
and otherwise, in the pace of economic activity. Member banks were
expected to be discouraged from extending credit in forms not directly
related to the current output of goods and services in the economy by
the fact that loans on securities, real estate loans, and long-term
credits of any kind were not eligible paper.

In view of this dominant banking-school philosophy in the
original Federal Reserve law, it was natural and proper that
Regulation A, when first issued, should be mainly concerned with the
self-liquidating quality and maturity features of paper eligible for
discount at the Reserve Banks or as collateral for Reserve Bank
advances, and should rely primarily on a restatement of basic legal
authority stated in the Act.

Early in the System's history, the strict banking theory of
discount operations was compromised. As a result of exigencies of
World War I finance, the discount of customers' paper collateraled
by Government securities was permitted as were also 15-day advances
to member banks on Government securities. About this time, acceptances
drawn to create dollar exchange (finance paper) were made eligible.
Again, as a result of postwar agricultural crisis, agricultural paper
of a maturity outside a strict banking principle range was more freely admitted to eligibility.*

During the Twenties, member banks appeared to feel that their holdings of eligible paper and of Government securities were adequate. They were not discouraged from allowing an unusual growth of credit types at variance with self-liquidating banking doctrine by the fact that these assets were not eligible for discount. It was also demonstrated in this period that banks would borrow in the most convenient manner, with the result that a large proportion of the borrowing was in the form of 15-day advances against Government securities and in the form of advances against eligible paper. Discount of eligible paper, when used, reflected mainly borrowing for periods longer than customary for advances.

Altogether, the experience of the Twenties showed that there is little relation between the character of paper discounted and the use to which banks put the proceeds, and further that little regulative influence could be exerted over member bank lending policies by limiting to eligible paper their access to Reserve Bank credit. Although eligibility imparted some preferential status to the kinds of paper covered, it did not restrict member bank acquisition of other kinds as long as banks considered their liquidity and secondary reserve positions to be adequate for operating needs.

*The maximum discount period of 90 days permitted by the original Act for eligible commercial paper was thought to conform roughly with the average production cycle of commerce and industry. Agricultural paper maturing in not more than six months was initially eligible for discount in limited amount, and presumably the adoption of a nine month maximum period on agricultural paper in 1923 was to extend the principle of conformity of eligibility to the production cycle to such paper.
With banking crisis and severe economic recession in the early Thirties, needs of individual banks for access to Reserve Bank lending facilities became large relative to their holdings of eligible paper and a lack of such paper became a handicap—even a solvency threat—to individual banks faced with emergency reserve drains. Also, the inadequate amount of eligible paper actually offered for discount by member banks having a supply hampered the Federal Reserve in meeting the currency as well as the reserve needs of the country.

This experience proved that the formalistic eligibility standards established up to that time could be seriously detrimental to the performance of necessary banking and reserve banking functions in a period of severe economic contraction. An increasing number of banking students contended that the ultimate quality or soundness of paper held by member banks should be the test of discountability at Reserve Banks rather than eligibility under mechanical rules.

Thus the eligibility basis for operation of the discount mechanism proved unsatisfactory in two decades of experience under varying conditions and this experience set the stage for what amounted to an abandonment of the banking principle in discount operations and in the collateral requirements for Federal Reserve notes. Congress in 1932 amended the Federal Reserve law to reflect a change in its intention as to the character of assets that may be used as a basis for credit extension by the Reserve Banks. Congress gave to the Federal Reserve System temporary authority in exceptional and exigent circumstances to make advances to member banks "secured to the
satisfaction" of the Reserve Banks and also authority for the
Reserve Banks to collateral their note issues by Government securi­
ties as well as by eligible paper or gold for the amount of cover
in excess of the minimum gold reserve requirement. These temporary
authorities were subsequently extended and later were made permanent
amendments to the Federal Acts without limitation as to use.

Concerning the Reserve Bank authority to extend advances
secured to their satisfaction, the House Banking and Currency Committee
in recommending in 1935 its permanent enactment reported:

"This amendment, by removing many of the technical
restrictions of the present law, will enable the Federal
Reserve Banks to render better service to their member
banks in times of need. This will not only make member­
ship in the Federal Reserve System much more attractive
but will encourage the member banks to invest their
savings deposits, which are essentially capital funds,
in longer-term loans, a course that would greatly facili­
tate business recovery.

"This amendment will also make it possible for banks,
without relaxing prudence or care, to meet local needs
both for short-term and for long-time funds, and to be
assured that in case of need they can obtain advances
from the Reserve banks on the basis of all their sound
assets, regardless of their form or of the nature of the
collateral. Soundness of assets (a term which is here
for the first time introduced into the Federal Reserve Act)
is a greater safeguard to the banks than short maturity of
loans or the particular form of the underlying transaction."
(House Report 742, 74th Cong.)

Congress in 1933 widened the breach with the banking principle
of reserve banking by amending paragraph 8, Section 4, of the Federal
Reserve Act to make each Reserve Bank responsible for taking into account
in lending whether borrowing banks were making undue speculative use of
bank credit or employing bank credit for any other purpose inconsistent
with the maintenance of sound credit conditions. This action recognized
that eligibility rules could not assure that member bank loan and investment activities would be confined to channels consistent with stable economic development, that Federal Reserve responsibility for the soundness of credit conditions does not end with control of its own portfolio, and that the tendering of acceptable security by a member bank is not a sufficient basis for the extension of Federal Reserve credit. By this amendment, together with amendments authorizing loans secured to the satisfaction of any Reserve Bank and freeing the note circulation of its tie with eligible paper, the Federal Reserve was given more comprehensive discretionary power to regulate the flow of credit and money and a responsibility for formulating and stating principles to govern access to its discount windows.

The revision of Regulation A in 1937 had the objective of giving administrative recognition to the supersession of puristic banking-school doctrine as the underlying principle of discount operations in Federal Reserve law. It accomplished this end by: (a) incorporating a preface of general principles which paraphrased paragraph 8, Section 4 of the Act, referred to above, and stated that the guiding aim of discount policy was advancement of the public interest; and (b) aligning the various eligibility and advances provisions to the statutory amendments of the 1930's as then interpreted. The new version of the Regulation, in addition, included three provisions further underscoring departure from earlier discount theory. It made eligible domestic finance paper, thus removing an ineligibility that had ruled for nearly two decades. Second, it provided limitations on the extent to which Reserve Banks, in view of their public
responsibilities, might require additional collateral for their own protection in extending credit accommodations. Third, it set forth in an appendix recommended minimum standards to be observed by member banks in extending real estate loans or acquiring instalment loan paper, with a view to making such assets acceptable as the basis for Reserve Bank advances under Section 10(b) of the Federal Reserve Act.

But, as noted earlier, the revised Regulation A gave the impression of continuing to accent the legal eligibility of the paper offered for discount rather than the appropriateness of the borrowing as the mainstay of Reserve Bank lending. This impression was conveyed by several features of the revision. The space devoted to legal eligibility features continued relatively large. A hangover influence of the eligibility principle was reflected in an enumeration of preferred classes of bank assets as collateral for borrowing secured to the satisfaction of the Reserve Banks under Section 10(b) of the Federal Reserve Act. Ambiguity of the amended Federal Reserve Act with respect to the permissible maximum maturity on advances secured by Government obligations was carried over into the regulation, with the result that character of the paper rather than nature and appropriateness of the borrowing seemed to be highlighted as the maturity guide for Reserve Bank advances against Government securities.*

*The 1937 revision retained in the text the requirement for a maximum 15-day maturity on such advances but added a footnote stating that under paragraph 13, Section 13 of the Federal Reserve Act advances might have a maturity of 90 days. In 1942, the regulation was amended to substitute in the main text a permissible maximum maturity of 90 days, with a footnote explanation of the technical reasons therefor, apparently to put the maximum maturity in line with that on other eligible paper.
From the mid-Thirties on until 1951, only nominal use was made by member banks of the Federal Reserve discount facility so that there was little occasion for special System interest in the substance of its discount regulation. Such discounting as was done was primarily by short-maturity advances collateraled by Government securities.

This absence of member bank borrowing need for almost two decades reflected in the first instance the impact of System open market purchases to relieve banking crisis in the early Thirties, secondly, the large mid-depression influx of gold, and later during the war and postwar periods Federal Reserve operations in support of Government security prices. In consequence of Government financing of economic recovery and then of war, banks over much of this period experienced an appreciable rise in the proportion of their assets in the form of Government security holdings. Even though this proportion declined somewhat after the war, it still remained at approximately 45 per cent at the point of post-Korea inflationary crisis when the System discontinued support operations in the Government securities market.

In the inflationary conditions then obtaining, when Federal Reserve policy became directed at reducing spending pressures in the economy by limiting the availability of Federal Reserve credit, member bank borrowing rose, first gradually and then in 1952 abruptly. This borrowing was again primarily on member bank notes collateraled by Government securities, clearly the most convenient form of borrowing under the circumstances.
In part the rapid rise in borrowing during 1952 was a direct effect of restrictive credit influence exerted by the System. But it also represented borrowing by some member banks to avoid excess profits taxes, by others to profit from differentials between prevailing discount rates and market yields that developed under the tightening credit market conditions, and by still others to supplement operating resources in order to accommodate the active credit demands being generated by inflationary trends. These developments in particular brought under discussion within the System the whole question of the philosophy and effectiveness of its existing discount mechanism.

Essential Content of a Revised Regulation A.--One result of this recent discussion was to put in sharp focus the need for the System to develop a set of principles and standards to govern lending to member banks now that borrowing so largely takes the form of advances on Government securities. It is important to meet this challenge, the Committee feels, if the System is to function under a discount philosophy suited to the operating needs of individual member banks as well as to the requirements of law and to over-all monetary policy directed at economic stability and growth.

Absence today of such a philosophy has undesirable results. It leaves the System exposed to possible criticism for not giving more definite and precise regulative expression to the standards which it believes should govern use of the discount facility. Member banks are left uncertain as to their privileges and obligations in resort to the discount facility. The tradition against large and continuous borrowing,
being without adequate regulative support, is subject to the risk of weakening in periods of credit tightness, thereby adding to the burdens which other instruments of Federal Reserve action must bear and retarding the attainment of general policy objectives. Lack of a modernized System discount philosophy, finally, is a factor fostering undesirable regional differences in discount practice.

In the light of the System's entire experience with the discount mechanism, the Committee has given extensive thought to the substance of a revised Regulation A appropriate to present and future circumstances, in so far as future needs may be foreseen. It appears to the Committee that a revised Regulation A, designed to meet present-day banking and monetary requirements should:

(a) Recognize that advances on Government securities rather than discounts of other paper are the customary basis for discount credit;

(b) Explain briefly the broad purpose of the Federal Reserve System and make plain the relationship of the Reserve Bank lending facility to other System means of providing or absorbing reserve funds;

(c) Emphasize that borrowing is a privilege and not an unqualified right of membership;

(d) Contain a statement of general principles to guide Reserve Banks in lending and member banks in Reserve Bank borrowing;

(e) Make clear that, in extending credit to member banks, the Reserve Banks are obligated to take into account all of the circumstances surrounding the loan, that is to say, the appropriateness of the loan itself and not primarily the nature of the paper securing it;

(f) Differentiate sharply between principles applicable to ordinary discounting and those applicable to emergency situations;

(g) Give assurance to banks of the generous availability of discount credit in cases of emergency;
(h) Express strongly the limitation of ordinary use of Reserve Bank discount facilities to short maturities, thus facilitating, when desirable, a discount rate differential by maturity of borrowing (e.g., between 15-day and 90-day advances with a higher discount rate applicable to advances in excess of 15 days);

(i) Distinguish clearly between the availability of the discount facility to member banks and the circumstances under which it will be available to nonmember banks, who have chosen not to accept the responsibilities and privileges of membership; and

(j) Be streamlined as to technical features, with restatement of only essential statutory substance and with elimination of items clearly obsolete.

Guiding Principles for Reserve Bank Lending and Member Bank Borrowing.--The Committee believes that a foundation for needed principles of guidance for Reserve Bank lending and member bank borrowing may be found in the present Federal Reserve Act, interpretations of the Act with respect to discounting made by the Board of Governors over the years, and the experience of the System with the discount mechanism over four decades of operation. On the basis of its studies, the Committee offers eight guiding principles for System consideration and possible incorporation in a revised regulation. These principles, which are closely interrelated, are designed to give clear and full expression to the discount obligations of the Reserve Banks as they are stated in, or implied by, present law.

In advancing these principles, the Committee wants to emphasize that it is aware that exceptional situations, particularly smaller bank situations, will require application of the principles in accordance with a rule of reason and on the basis of the best administrative judgment of the Reserve Bank officers concerned. The principles are
intended to be general guides and standards and not precise administrative instructions inflexibly applicable to all cases.

The eight principles, with accompanying Committee comment on each of them, are stated below:

"(1) Due regard must be given to the effect of any extension of credit upon the maintenance of sound credit conditions, both as to individual institutions and as to the economy generally. Accordingly, consideration should be given to the effect that the granting or withholding of credit accommodations may have upon the applicant member bank, its depositors, and the community and its credit needs, and whether the member bank is conducting its operations in a manner consistent with sound credit conditions."

Comment: This general principle has the object of making explicit the meaning of the statutory phrase "maintenance of sound credit conditions."

"(2) Federal Reserve credit should normally be extended for short periods to meet temporary credit needs of member banks. (For example, extension of Federal Reserve credit is appropriate in order to enable a member bank to adjust its asset position because of such developments as a temporary loss of deposits or to assist a member bank in meeting requirements for seasonal credit which cannot reasonably be anticipated and met by use of the member bank's own resources.)"

Comment: This principle underscores the short-term nature of ordinary member bank use of the discount facility. The limitation of central bank credit to short maturities is a recognized principle of central banking. The original Federal Reserve Act emphasized short-term maturities but in relation to the self-liquidating character of the paper offered for discount. Now that the self-liquidating idea is no longer the central precept in Federal Reserve law and discount philosophy, it seems desirable to make plain that the System accepts the short-term maturity principle as sound by expressing it directly and prominently in regulation.
System experience shows that a 15-day maturity is usually adequate for meeting temporary adjustments in member bank positions. It is the maximum provided in the law for advances to member banks on Government securities, except for the special authority applying to any individual, partnership, or corporation which would seem to contemplate unusual and exigent circumstances for borrowing.

Accordingly, in addition to a definite statement of adherence to the short-term maturity principle, the Committee suggests emphasis on 15 days as the usual maximum maturity for temporary borrowing at various points in a revised regulation.

The Committee feels that a standard adherence by the Reserve Banks to a 15-day maximum maturity for temporary borrowing would support the tradition against continuous member bank indebtedness by placing squarely on individual banks two essential responsibilities: to keep liquid; and to keep assets so distributed as to enable them to meet out of their own resources such drains of funds as are normal to their banking business.

If the member banks generally meet their normal operating responsibilities, use of the System discount facility would ordinarily be limited and would increase appreciably at times only in response to System operations directed at credit restraint. With member banks generally confining their borrowing to temporary needs, tightening monetary pressures, which expand member bank indebtedness to Reserve Banks, would be reflected promptly in restrictive lending and investing policies on the part of individual banks in order to repay debt. Such tightening monetary pressures would also be reflected in indebtedness of an increasing number of member banks, a development which would be salutary under the circumstances as a means of spreading the restrictive influence and of communicating the fact of credit tightness throughout the market for bank credit.

Special attention is called to the reference to borrowing for seasonal purposes because the Committee has found widely differing views within the System as to the nature of the seasonal circumstances that would justify any extended member bank borrowing. It appears to the Committee that a limitation of Reserve Bank credit extensions for seasonal requirements to those "which cannot reasonably be anticipated and met by the use of the member bank's own resources" is a desirable safeguard for preventing undue reliance on use of Federal Reserve credit for seasonal purposes. Also, it is an essential step in keeping Federal Reserve credit extension through the discount window
effectively dovetailed with provision of seasonal credit through open market operations.

An extended discussion of the use of the discount facility for meeting the seasonal needs of member banks for reserve funds is contained in Appendix B of this report. The discussion recognizes that there will be extraordinary seasonal cases, most likely smaller bank situations, which will require discount acceptance on the basis of a reasonable evaluation by Reserve Bank officials of the special considerations giving rise to the borrowing need.

"(3) In order to enable a member bank to meet unusual and exigent situations, Federal Reserve credit should be extended for as long a period as may be deemed necessary whether such situations may result from a national economic emergency, or from exigent regional or local conditions, or, in certain situations, from an emergency involving only the particular member bank."

Comment: This principle has the aim of assuring member banks that, to meet situations arising from emergencies, Reserve Bank credit is to be freely and liberally available for as long periods as circumstances may require. While it is not the function of the Reserve Banks to underwrite the solvency of their member banks, it is their function, in the Committee's judgment, to help member banks in emergencies to avoid insolvency from lack of liquidity. This is the long-accredited "lender of last resort" principle of central banking.

"(4) While unusual and exigent circumstances or special local economic needs may justify continuous borrowing by a member bank over a considerable period of time, under ordinary conditions continuous use of Federal Reserve credit by a member bank so as in effect to increase its resources, whether by long-term borrowing or by frequent short-term borrowing, would not be an appropriate use of Federal Reserve credit."

Comment: If there is any clear lesson out of the bank failure experience of the first two decades of Federal Reserve operation, it is that it is unsound for any member bank to so use Reserve Bank credit as to increase in effect its own resources. Banking as a financial business operates with a thin margin of capital, and any bank which substantially and continuously relies on funds in a creditor position ahead of those deposited with it, both endangers its depositors' position and incurs additional risks of insolvency. Since the Twenties, the capital margin of commercial banks generally has fallen appreciably further. In view of the
statutory responsibility of the Federal Reserve for maintaining sound credit conditions, the Committee believes that the System must take every precaution to avoid contributing through its discount operations to unsound individual banking situations.

The Committee is aware that, since the early Twenties, the System’s continuous borrowing problem has been chiefly one of a relatively small number of aggressive banks taking advantage of every opportunity, including that of Reserve Bank borrowing, for adding to their resources and profits. Definition of continuous borrowing in a way that will exclude in advance discounts to supplement a bank’s operating resources is admittedly difficult. But it would seem to the Committee that the number of discount cases raising a continuous borrowing question would be minimized if the System expresses clear-cut regulative disapproval of such borrowing from the Reserve Banks except in emergency circumstances.

Identification of discounts presenting a continuous borrowing aspect will be facilitated by the development of objective standards for defining and identifying such instances. Appendix C considers the problem of developing appropriate standards for determining continuous borrowing cases, and emphasizes that the standards arrived at must have a quality of reasonableness derived from actual discount experience.

A practical issue in this connection is whether continuous borrowing is to be defined in terms of the number of successive reserve periods in which an individual member bank borrows as well as in terms of the number of consecutive days a member bank remains in debt. The Committee feels that both types of discount use are to be classified as continuous borrowing. Borrowing for one or a few days in successive reserve periods as an offset to recurring reserve deficiencies serves to supplement the member bank’s own resources as if it had borrowed a smaller amount continuously over the entire period. Further discussion of this issue is provided in Appendix C.

"(5) In determining whether to grant or refuse credit to any member bank, the Federal Reserve Banks are required by the law to consider the general character and amount of the loans and investments of the member bank and whether the bank is extending an undue amount of credit for speculative purposes in securities, real estate, or commodities."
Comment: While this principle simply paraphrases the law with respect to consideration of the general financial position of the borrowing bank and to undue extension of its credit for speculative purposes, its separate statement has a further purpose. It serves to emphasize that it is primarily the acceptability of the loan in terms of the general banking use made of proceeds by the discounting bank and only secondarily the eligibility of the paper offered for discount which is the statutory and regulative basis of Reserve Bank credit extension.

"(6) Federal Reserve credit should not be extended where it appears that the member bank's principal purpose is to profit from rate differentials or to obtain a tax advantage."

Comment: The Committee is cognizant of the fact that it may be administratively difficult to determine in all cases whether Federal Reserve credit is being used primarily for the purpose of profiting from rate differentials. At several of the Reserve Banks, however, procedures have been worked out for appraising a member bank's motives, especially where that bank is more than a very temporary borrower, which have reassured the Committee that the problem can be handled satisfactorily. The Committee feels that it is important to express directly the view that Federal Reserve credit is not to be used to avoid taxation, such as excess profits taxes.

"(7) The law permits only such extensions of Federal Reserve credit as may be 'reasonably and safely made'; and the acceptability of paper offered for rediscount or as collateral for advances must be determined in the best judgment of the Federal Reserve Bank in accordance with the provisions and objectives of the Federal Reserve Act and this Regulation."

Comment: While "reasonableness" and "safety" in terms of acceptability of the paper offered as collateral or for rediscount is a consideration in discount operations, the range of judgment encompassed by these words is to be set by the full substance and purpose of law and regulation.
"(8) The board of directors of each Federal Reserve Bank is required by law to administer the affairs of such Bank fairly and impartially and without discrimination in favor of or against any member bank or banks. Accordingly, in passing upon a member bank's request for credit, due regard must be given to the claims and demands of other member banks."

Comment: This principle calls attention to the duty of the Reserve Banks to apply uniform credit standards in extending credit to all of its member banks and generally to maintain credit standards which are in line with those being applied by other Reserve Banks. It seems reasonable that a member bank should not be able to obtain credit from its Reserve Bank on terms and conditions that are not generally available to member banks and that could not be made available to any of them without working against the System's general credit policy.

Suggested Revision of Regulation A.--In the light of its findings and its consideration of the appropriate scope of a discount regulation, the Committee suggests a revision of Regulation A that would accomplish the following four objectives:

1. Set forth general guides and standards as to the proper use of the discount facility that would reflect a positive discount philosophy based on System experience and the banking theory on which existing law now rests;

2. Reenforce the tradition against large and continuous reliance by member banks on the discount facility without unduly limiting temporary access to discounting and assuring emergency access to it;

3. Be consistent with the present and prospective monetary setting; and

4. Allow adequate leeway for necessary Reserve Bank discretion in dealing with individual borrowing situations.

The Committee has requested the Board's staff to prepare a suggested draft of a revised regulation that would incorporate the eight guiding principles discussed above and otherwise conform to the Committee's
general ideas. Such a draft, preceded by a brief review of major substantive and technical changes included, is presented in Appendix D of this report. The Committee refers this draft to System officials for their study and consideration.

Administration of Discount Policy

Review of System administration of its discount function in connection with the Committee's work has shown to its satisfaction that at each Reserve Bank this function is competently and responsibly handled. Such problems or deficiencies as are encountered in discount administration do not seem to be the result of inappropriate implementation of the present Regulation A. They would appear rather to reflect a System lag in adopting an informative and definite statement of principles regarding the appropriate availability of discount credit under the Federal Reserve Act as amended and in the light of present-day banking needs.

It seems to the Committee that revision of Regulation A along lines outlined in this report would strengthen the System framework for administering discount policy and would facilitate as much standardization of discount practice among the twelve Federal Reserve districts as may be desirable. In taking into account the eight guiding principles which the Committee recommends for a revised regulation, each Reserve Bank would be evaluating the acceptability of the individual member bank borrowing in terms of common standards.

This responsibility on the part of the Reserve Banks to apply common standards as to the eligibility of individual member bank loans, the Committee recognizes, would entail more burdens in discount review
than does consideration primarily of acceptability of offered paper. The directors of each Reserve Bank might wish to assign the problem of adapting existing procedures and practices to the requirements of a revised Regulation A to the Bank's discount committee, usually composed of its senior officers. The directors might also wish to delegate to the discount committee the task of continuing systematic review and oversight of the Banks' discount operations in the light of a new Regulation A.

For reasons set forth in the preface to this report, the Committee contemplates that the discount instrument under foreseeable circumstances will function in general credit policy coordinately with open market operations and changes in reserve requirements. To insure that discount operations under a revised Regulation A would be administered with a full understanding of the current credit situation, every care should be taken to keep the chief discount officer of each Reserve Bank briefed currently on System credit policy. For this purpose, the Committee would urge that this officer should regularly participate in major staff and director discussions of general policy objectives and methods.

While the Committee contemplates a System discount activity varying in accordance with general credit policy, it wishes to stress particularly that it is not recommending a set of discount principles that would in themselves flex with such policy by administrative discretion. The principles for discounting which it advances for consideration would be applicable under all conditions of general credit policy. To the extent that exceptions (other than for very special situations) are required to a general practice of discounts
only for temporary purposes, such exceptions would be made on the
grounds of unusual and exigent circumstances arising out of national,
regional, and local emergencies, or emergencies involving an individual
member bank. Primarily, this emergency discount principle asserts that
each Reserve Bank is under obligation to prevent member bank insolvency
arising purely from the lack of liquidity in an emergency; it is not
contemplated by the Committee that the principle would provide a special
category into which, and out of which, discount cases would be moved as
general credit policy is tight or easy.

One aspect of discount administration under a revised
Regulation A would be more attention to the purposes of member bank bor­
rowing. It would seem appropriate for the Reserve Banks on discount
application to look into the chief reason for borrowing need (i.e., "loan
increase," "deposit decline," or "securities purchases") so that member
banks would be aware that the use of borrowed reserve funds is a con­
sideration in making advances.

Each Reserve Bank would need, of course, to engage in analyses
of changes in the balance sheet items of its member banks and of the
seasonal changes in their loans and deposits so that it would be in a
position to make an independent, objective judgment of the factors
giving rise to borrowing. The accounting and statistical methods
applicable to such appraisal are now well known and their adaptation
by Reserve Bank discount and research departments, working in collabora­
tion, would not present too difficult technical problems.
The Committee recognizes that promptness of discount action would require reliance in the first instance on a member bank's own statement of purpose, but believes that the objective procedures proposed above, even though applied in many instances subsequent to actual borrowing, would facilitate administration where findings indicated that developments other than those stated were responsible in significant degree for the borrowing.

The Committee also recognizes that the information needed for such objective analyses would not be uniformly available at all Reserve Banks unless special reports were designed to obtain it. The suggested draft revision of Regulation A, appended to this report, includes a more specific authority for each Reserve Bank to require from any of its member banks such information as may be needed to determine whether any requested discount accommodation would be inconsistent with the Committee's guiding principles.

While some incompatible interdistrict differences in discount methods may now exist, the Committee is persuaded that differences not supported by variations in regional conditions and needs would be largely eliminated by a Regulation A reoriented along the lines suggested. As a means of furthering this development, it would seem desirable that there be occasional meetings of System discount officers, with perhaps the Directors of the Board's Divisions of Bank Operations and Examinations also included. Such meetings would serve as a forum for discussion of common problems.
The Committee is aware that the theory is still held by some member banks that a Reserve Bank has no right to refuse accommodation to an applying bank if it offers acceptable security. Although the ghost of this theory was laid legislatively by the enactment in 1933 of an amended paragraph 8, Section 4, of the Federal Reserve Act, it would appear desirable for the Reserve Banks to continue in their bank relations programs to refute the theory. Accordingly, each Reserve Bank might take occasion at appropriate times to inform their members as to proper and improper uses of Federal Reserve credit. A revised Regulation A, making clear the standards of proper use of the discount facility would be an aid to these programs.

Some Objections to the Suggested Revision of Regulation A

The Committee is aware that various objections may be raised to a revised discount regulation which would place primary emphasis on the appropriateness of the borrowing and only secondary emphasis on the character of the paper offered for discount. Some objections would question the discount philosophy which underlies the suggested revision of the regulation; others might be based on practical obstacles to applying a revised regulation based on this philosophy. Since it is important that the principal suggestions made in this report be assessed in the light of possible objections to them, the Committee in this section undertakes to review the objections which have come to its attention in its own discussions.
Substitution of Regulation for Tradition Against Discounting.--A key premise underlying the Committee's suggested revision of Regulation A is that explicit standards for use of the discount facility would reenforce the member bank tradition against borrowing by providing a frame of reference for evaluating undue reliance on discounting by aggressive member banks. It may be objected, of course, that an effect of the revision might be to substitute regulation for tradition. If the regulation were to be revised along lines indicated, and especially if the discount standards advanced should come to be applied too inflexibly by Reserve Banks, singly or jointly, then regulation could tend increasingly to supplant tradition. A possible undesirable result might be that member banks would become more and more concerned with narrow compliance to regulation and less and less concerned with adherence to sound banking principles as such.

If there is in fact a well established tradition against borrowing, moreover, it may be said that the tradition itself can be enough of a reliance for the System against undue member bank use of the discount facility. Assuming that, in the case of some banks, the tradition could be strengthened, such strengthening may also be effected under the present regulation by timely and appropriate educational activities on the part of the Reserve Banks.

System's Discount Mechanism Problem Mainly One of Insistent Borrowers.--The System's discount mechanism problem over the years, it can be claimed, has been chiefly one of dealing with aggressive banks. Since the post-World War I experience, the problem
has been mitigated by a strengthening of the tradition against borrowing and by System experience in dealing with problem cases. This objection would point out that, during the 1952-53 experience, when there were both excess profits tax and interest rate incentives to member bank discounting, only a relatively small number of banks presented problems, and comparatively few banks a serious continuous indebtedness problem. After some intra-System discussion of applicable standards the exceptional cases were identified. When the inappropriateness of their borrowing practices was called to their attention, the banks in question for the most part were prepared to take corrective action without further pressure. Only a very few banks turned out to be insistent borrowers, and, in each District, they were dealt with on a case-by-case basis.

While the handling of these cases may have been less uniform as between Reserve Bank Districts than might be desirable ideally, it may be argued that such unevenness of discount practice not justified by economic differences between the Districts may be readily corrected by a more active and systematic exchange of information on discount procedures among the Reserve Banks.

This less formalized approach toward making the System's discount mechanism more effective might give rise, admittedly, to some leakage of reserve funds as a result of unavoidable delays in recognizing problem borrowers and in taking action to deal with them. It might be said, however, that if the System were alert to such leakage of reserve funds, it could offset the leakage by other actions, including open market operations as well as use of the discount rate.
Those attracted by this objection to a revised discount regulation as a means of dealing with aggressive borrowers might further say that adoption of explicit discount standards, by tightening the discount mechanism, would be an undesirable substitute for reliance on the discount rate in curbing excessive discount volume. The point advanced here is that raising the discount rate to an effective level when appropriate to System credit policy is the established reserve banking means of restraining undue member bank use of the discount facility and, hence, the means with which the credit markets have a familiarity. Lessened reliance on the discount rate, consequently, might remove some of its significance as an objective index of credit conditions.

Adjustment Problem of Money Market Banks.—The adjustment problems of money market banks in periods of reserve pressure, it may be objected, would be made unduly difficult by changes in Regulation A and in administrative procedures to emphasize temporary borrowing and include repetitive borrowing in successive reserve periods as continuous borrowing. Reserve pressures of the banking system typically focus on money market banks, this objection goes, because other banks in times of pressure tend to meet their reserve needs in part by drawing on deposits with correspondent banks in financial centers and in part by selling securities which tend to be purchased by customers of money market banks. Moreover, sales of securities in such conditions by money market banks may result in a less than equivalent reserve gain, since some securities sold may be purchased by their own customers.
In periods of credit tightness, it is consequently claimed, financial center banks unavoidably react to market pressure by repetitive borrowing from the Federal Reserve.

In assessing this objection, special recognition needs to be given to the fact that one of the characteristics of money market banks, and one to which adjustment in their lending and investing activities is necessarily required, is that they are subject to extra heavy reserve pressures at times of credit tightness and contrastingly great ease at times of general credit ease. For this reason, they may be expected to hold a large proportion of short-term readily marketable assets with which to cushion the impact of changing market pressures.

If, as a result of a revised discount regulation, banks generally come to consider both uninterrupted and repetitive borrowing as inappropriate, then restrictive policy by the System would be more promptly reflected in bank lending activity. The restrictive effect would occur before the build-up of discounting reached as large a volume as it would need to if banks were more complacent borrowers. Under these conditions the System would normally have to make available through other channels a larger proportion of the reserves required by the banking system.

Adverse Bank Relations Aspects of a Revised Regulation A.--The suggested revision of Regulation A might accentuate the System's bank relations problem. Placing primary emphasis on the acceptability of the borrowing, the argument would run, might give rise to undesirable criticism of the System by member banks. Banks might feel that every time they applied for an advance, no matter how temporary the need,
they would be subjected to special review and that they would be subject to continuing administrative review until the advance was repaid. They might further feel that regulatory emphasis on short-run borrowing might imply that any continued indebtedness occasioned by deposit movements beyond their control would reflect on the soundness of their operations.

On the other hand, the suggested revision of the discount regulation does little more than give interpretative expression to provisions already in the law. The majority of member banks are now administering their affairs in line with the philosophy of the suggested revision. These banks, therefore, might feel kindly rather than antagonistic to a revision of the regulation that would help bring less conservative banks into conformity.

Possible Reactions on Correspondent Banking.—A possible effect of the revision of Regulation A herein outlined, it could be claimed, would be to force increased dependence on correspondent banking relations. The argument would assert that such dependence would result from greater willingness to borrow from correspondents on the part both of banks that expected correspondent lending standards to be easier than System standards and of those that were resentful of System review of the appropriateness of their borrowing. Thus member banks would be encouraged to build up correspondent balances in times of credit ease so as to be in line for such loans, and those banks that succeeded in establishing strong correspondent banking relationships would put themselves in an advantageous position.
Concerning this objection, two observations may be made. First, there is nothing inherently wrong with greater dependence on correspondent banking relationships, even if such dependence results from regulative changes. The second point is that lending by correspondent banks cannot result in any net release to the banking system of reserve funds and consequently in no general increase in resources available for expansion of the money supply. To the extent that commercial banks make loans to correspondent banks, they must curtail loans to their nonbank customers.* Lending by the Reserve Banks, on the other hand, does involve a release of reserve funds.

The Avoidance Problem that Might Result from a Revised Regulation A.--A problem which might become important if Regulation A were revised as suggested, it may be alleged, would be the possible resulting rewards to any member bank able to avoid its limiting provisions, especially if the discount standards adopted had the effect in practice of subordinating discount rate flexibility. While the revised discount regulation would be in general language, that language would express a positive discount philosophy and presumably the Reserve Banks, acting individually or jointly, would give the stated discount standards an even more specific content in actual administration. The hazard for System operations, the objection would contend, would be that the administrative rules of the Reserve Banks might become too mechanical.

*Such loans might transfer reserves from banks with higher reserve requirements to banks with lower reserve requirements. Since deposits resulting from bank lending activities rarely remain in the lending bank, however, there is no reason a priori to expect interbank loans to result in greater expansionary possibilities on the basis of a given amount of reserves.
If this should happen, then some member banks might manage their discounting needs so as to circumvent the rules, and the benefits for the System believed to result from a more positive discount philosophy would fail to be realized.

Relation Between Regulation of Discounting and Discount Rate Policy

The Committee has yet to complete its study of considerations relevant to the appropriate level of the discount rate and of criteria for guiding Reserve Bank changes in the rate. It is clear, however, that administration of discounting and of discount rate policy are closely interrelated and that any change made in general policy concerning one will also affect the other. Accordingly, the Committee feels that it is proper to include in its initial report some tentative observations on the relation between the regulation of discounting and discount rate policy.

A firm tradition against continuous borrowing, clear and informative regulative standards as to the appropriate conditions for member bank borrowing, and a proper discount rate are each means of keeping down member bank discounting and of helping to limit the supply of reserves when credit demands are strong. The greater the role played by any one of them, the less need be the part played by the others. If member banks are reluctant by tradition and regulation to borrow or, having borrowed, to remain long in debt, then increases in market interest rates and restrictive availability of credit to bank customers will result from the mere fact of indebtedness. Therefore, the level of the rate will assume less importance than if banks felt free to borrow and to remain in debt in order to take advantage of profit opportunities.
If member banks generally felt free to borrow and remain in debt when borrowing was profitable, the discount rate would need to be adjusted frequently to keep it at a level equal to or not far below short-term market rates in order to function as a primary deterrent to discounting when the demand for credit is high. If member banks limited their ordinary discounting to meeting temporary needs pending other adjustments, however, the sensitiveness of their borrowing to the spread between the discount rate and market rates would be less marked. The need for frequent changes in the discount rate to keep borrowing from appearing profitable, therefore, would be diminished.

This is not to imply that, with a revised discount regulation, changes in the discount rate would not continue to play a significant role in general credit policy. They definitely would have an important function. For one thing, changes in discount rates would continue to serve as an objective indication to the business and financial community of System credit policy. For another, in periods of high demand for credit and rising market and customer rates, increases in discount rates would continue to be an essential protection to an effective mechanism. Since there will always be banks aggressively alert to profit opportunities, the number of problem discount cases would naturally increase if the discount rate were kept too low in relation to market and customer rates. Moreover, a rate increase could be helpful in checking the willingness of banks to resort to temporary discounting. It would do this by raising the discount rate relative to market yields on short-term securities, thus inducing some banks to liquidate assets rather than to incur the cost of temporary borrowing.
The discussion thus far has been concerned primarily with the effects of the suggested revision of Regulation A on the role of the discount rate in periods of inflationary pressures when it is necessary to restrict the supply of reserve funds. The effect in periods of declining credit demand, when System policy would be directed toward cushioning credit contraction and encouraging resumed expansion, need be touched on only briefly. The role of the discount rate as such in this kind of situation is more limited. A low discount rate can serve as one indication of the System's attitude toward credit conditions and of the type of general credit and monetary policy that the System is following. The role of the rate as a cost of borrowed funds in such periods is minor, however. On the basis of the System's varied experience in adapting to changing credit conditions, it is generally agreed that banks should be largely freed from indebtedness when the objective of System policy is to cushion credit contraction and encourage resumed expansion. Thus, the suggested revision of Regulation A would have comparatively little effect on the role of the discount rate in periods of declining credit demands.
APPENDIX A

SYNOPSIS OF REPORTS BY FEDERAL RESERVE BANKS ON THE OPERATIONS OF THE DISCOUNT FUNCTION*

This synopsis deals with the more important factors relating to discount procedures reported by the Federal Reserve Banks in April and May of 1953 when this survey was conducted.

Reserve Bank Administration of the Discount Facility

Approval of Discounts.--Considerable variation exists among the Reserve Banks in the organization for approving discounts. Most of the Banks make a distinction in the handling of applications considered "routine" and those in which the circumstances surrounding the applications are "unusual". No uniform or clear-cut definition as to what constitutes "unusual" circumstances was given. It appears, however, that the bulk of the applications are considered "routine".

Where an application is classified as routine, seven of the Reserve Banks stated that the officer or officers in charge of the discount function decided to grant or refuse individual loan applications, subject to review of their action by the Discount Committee. The officers in charge of the discount function at these banks are the First Vice President at Philadelphia; a vice president at Boston, New York and Atlanta; a vice president and assistant vice president at St. Louis; and a vice president and assistant cashier at Minneapolis. At Chicago the loan officers (Vice President and Assistant Vice President) or any member of the Discount Committee may pass on applications.

* Based on responses to the "Request for Information on Discount Procedures," attachments to letter Z-3715, dated April 29, 1953, to the Presidents of all Federal Reserve Banks.
Most of the foregoing Banks stated that where the circumstances surrounding the applications were "unusual" the decision concerning approval of an application was referred to the Discount Committee. At New York, where the President of the Bank is not a member of the Discount Committee, the Discount Committee may in matters involving important policy discuss the subject with the President and the Officers' Council. At Minneapolis applications presenting unusual features are reviewed by the Credit Committee, the President, and the Discount Committee.

At four other Reserve Banks the Discount Committee approves or disapproves all individual applications for credit after the officer in charge of the discount function has submitted such applications with his recommendations. The officers in charge of the discount function at these Banks are the Vice President in Cleveland, the Manager of the Discount and Credit Department at Richmond, the First Vice President at Kansas City, and the Assistant Cashier at Dallas.

The San Francisco Bank has no Discount Committee. At this Bank each application is approved or refused by three officers: the Assistant Cashier in charge of the discount function and two other officers, one of whom is the First Vice President or the President.

The composition of the Discount Committee at the 11 Reserve Banks which have such committees varies. At seven of the Banks this Committee consists of the senior officers of the Bank with the addition, in the case of three Banks, of the junior officer in charge of the discount department. At two other Banks (Richmond and Kansas City) the Discount Committee includes, in addition to the senior officers, the Chairman of the Board of Directors. At the New York Bank the Discount Committee consists of four vice presidents, the
Manager of the Discount and Credit Department and the First Vice President acting as an ex-officio member. At Minneapolis there are both a Credit Committee and a Discount Committee; the former, which acts in a similar capacity as the Discount Committee at other Reserve Banks, is made up of the First Vice President and two vice presidents, and the latter, which includes the Chairman and Vice Chairman of the Board of Directors and the President of the Bank, acts on individual applications only in extraordinary cases.

Participation by Boards of Directors in Discount Policy.--The Boards of Directors of the Reserve Banks participate in the determination of general discount policy principally by reviewing and approving the detailed reports of borrowing by member banks submitted to them at their regular meetings. Some of the Reserve Banks indicated that it was the practice of the Presidents to discuss discount policy from time to time with the Board of Directors and to obtain their views on the subject. Cleveland mentioned that the Board of Directors also participates in discount policy by prescribing loan values as guides in considering applications for advances under Section 10b. St Louis indicated that the Board of Directors sets the amount which may be loaned on U. S. Government and other Federal agency securities eligible as collateral under Regulation A.

The directors do not participate in the application of discount policy to individual situations at most Reserve Banks. There are, however, a few exceptions. At three Reserve Banks the Chairman or Vice Chairman of the Board of Directors, or both, are members of the Discount Committee and in this connection pass on individual applications for credit. At Philadelphia all reductions of indebtedness and refusals to extend credit are referred to the Executive Committee of the Board of Directors and at Dallas all "special situations" are referred to this Committee.
Current Discounting Practices

Major Criteria Considered

All of the Reserve Banks indicated that they do not use any formal or mechanical standard in determining whether an application for credit should be granted or refused. Current practices are flexible and depend upon analysis of the individual bank's situation in the light of its requirements, the needs of the community, and general economic conditions. Four basic factors are considered in analyzing an application for credit: purpose, size, maturity of the loan, and continuity of the applying bank's borrowing record. Differences in the weight attached to these factors would seem to be indicated by the various Reserve Banks.

1. Purpose of borrowing.--All of the Reserve Banks indicated that the purpose of the loan is the most important factor to be considered. However, in the situation that has prevailed for many years, when nearly all applications for credit have been based on Government securities, there is little disposition to ask for information concerning the purpose of the loan unless one or more of the other three factors--size, maturity, and continuity of borrowing--is considered "unusual."

There is substantial agreement that the following are inappropriate uses of Reserve Bank credit:

a. Borrowing for speculative or other purposes inconsistent with sound credit conditions.

b. Borrowing primarily to reduce excess profits tax liability.

c. Unwarranted expansion of loan and investment portfolio.

d. Borrowing solely to profit on the interest rate differential.
Wide variations appear to exist among Reserve Banks in the importance placed on these factors. Nearly all Banks said that purpose of borrowing was very difficult to determine. In most cases the purpose of borrowing is not clear-cut and frequently a combination of circumstances give rise to the need for credit accommodation.

Differences among Reserve Banks were particularly marked with respect to borrowing for excess profits tax purposes. Most Banks apparently feel that unless the borrowing is primarily or solely for excess profits tax purposes, it is not inappropriate, whereas other Banks appear to hold that any borrowing for tax purposes is inappropriate. Cleveland stated that four banks in its district were reported to be borrowing for excess profits tax purposes, but upon investigation valid reasons for the borrowing were found. Richmond indicated that Banks suspected of borrowing for excess profits tax purposes were told that the Reserve Bank was not concerned about the legitimate use of the provisions of the Internal Revenue Act, but banks should not borrow to increase their capital base.

On the other hand, Philadelphia cited the case of a bank which was asked to reduce its indebtedness because it appeared the bank had increased its borrowing beyond seasonal requirements for tax purposes. Minneapolis and Kansas City also cited cases of banks which had been requested to reduce their indebtedness because the credit was for excess profits tax purposes, and Dallas indicated that some prospective borrowers had withdrawn their applications upon being informed that borrowing for tax purposes was an inappropriate use of Federal Reserve credit.
Only five of the Reserve Banks, Richmond, Chicago, St. Louis, Kansas City, and San Francisco, expressed their views on the appropriate use of Reserve Bank credit, and they agreed generally that the following would be considered appropriate:

a. Borrowing to supply the seasonal requirements of business and agriculture.

b. Borrowing to meet an individual bank's short-term need for credit, such as an unexpected withdrawal of funds.

Chicago and New York implied that loans to money-market banks which assist in creating a market for Government securities would be considered appropriate.

2. Size of loan.—Although the size of the loan is a basic factor considered by the Reserve Banks, there is no general agreement on the method of determining how large a loan must be before it is considered questionable. Most of the Banks implied that size of loan in relation to required reserves is considered but they gave no clear indication of the manner in which the ratio is used. On the other hand, New York, Cleveland, Dallas, and San Francisco consider size of borrowing in relation to capital and surplus more significant than borrowing in relation to required reserves. Only Cleveland gave an example of what it considers a significant level of borrowing. It stated that a bank borrowing for the first time an amount equal to or greater than its capital or surplus would be questioned concerning the circumstances giving rise to the borrowing.

3. Maturity of loan.—All of the Reserve Banks except Chicago indicated that applications for 90-day loans were rare and that most applications for credit are for less than 15 days. St. Louis and Dallas have recently established the practice of making no advances in excess of 15 days, and Boston is now limiting borrowing to 30 days.
Nearly all of the Banks indicated that the circumstances surrounding a particular application should determine whether or not a 90-day loan is appropriate. With the exception of Chicago the Banks stated that applications for such loans have come principally from country banks in agricultural areas for the purpose of providing seasonal credit needs. Several banks stated that in such cases they encouraged banks to borrow for shorter periods with the idea that renewals would be granted if the situation warranted it.

In spite of the fact that they had had few applications for 90-day loans, Philadelphia and Atlanta said they had no restrictions on maturity of loans, and Philadelphia indicated that when they are requested to do so, they make loans for the full 90 days. Boston indicated that it saw little difference between a bank's rediscounting 90-day commercial paper and borrowing for 90 days on Government securities.

The Chicago Bank indicated that 42 per cent of all member bank applications for loans in its District in the first four months of 1953 had maturities in excess of 15 days. This Bank felt that 90-day loans were inconsistent with borrowing for temporary periods and that the appropriate sections of Regulation A should be revised to substitute a 15-day for the 90-day limitation.

4. **Continuity of borrowing.**--All of the Reserve Banks indicated that continuous borrowing is considered when passing on a loan application and that it is an undesirable practice. Nevertheless, there appears to be no uniform concept among Reserve Banks as to what constitutes continuous borrowing.

Philadelphia indicated that when a bank has borrowed continuously for three months it is put on a "watch list" and when it has borrowed continuously for six months, the case is reviewed by the Discount Committee and the Board of Directors.
Minneapolis, Dallas, and San Francisco said they did not relate borrowing to consecutive reserve computation periods, but in the case of Minneapolis to banks borrowing "rather continuously," in the case of Dallas to borrowing over an "extended" period of time, and at San Francisco to the number of days in which a bank borrows during a month.

Chicago and St. Louis indicated that if the borrowing is for temporary periods and for seasonal or local needs, it is not questioned.

Apparently none of the Reserve Banks classify a bank that borrows for a few days and is then out of debt for a few days, in the same statement week or the same reserve computation period, as a continuous borrower. Nor did any Reserve Bank indicate that a bank which borrows an amount equal to a substantial proportion of its average required reserves on one day of each reserve computation period is, in effect, a continuous borrower.

Application of Criteria to Individual Loans

Most of the Reserve Banks make a distinction in applying the foregoing criteria to individual loan applications depending on whether the application is classed as (1) routine or (2) unusual. While there is no uniform or clear-cut definition from Bank to Bank as to what constitutes the "routine" or the "unusual" loan, there are some areas of agreement concerning these loans and in the methods of handling them.

1. The routine loan.--Most banks would classify as routine a loan application which is secured by Government obligations and which, when examined with respect to size, maturity, and continuity of borrowing, raises no doubt concerning the desirability of extending the credit. Ordinarily no information concerning purpose is obtained in the case of a routine loan, except at Dallas where purpose is specified on all loan applications.
In the present period, when borrowing is confined chiefly to notes secured by Government securities, it appears that the bulk of all loan applications fall into the "routine" category. In these cases the discount department of the Reserve Bank determines whether the technical requirements for the loan have been complied with, and the loan is then approved by the appropriate Reserve Bank official.

2. The unusual loan.--Loan applications would be classified as unusual at most of the Reserve Banks if the borrowing was for an emergency, if the borrowing bank was already under surveillance, if the loan application was considered questionable on the basis of size, maturity, or continuity of borrowing, or if the purpose of the loan (where known) was believed to be inappropriate.

If the problems raised by the application can be resolved by the responsible Reserve Bank officials, the unusual loan is handled in one of two ways:

a. The loan is approved and it is then discussed with the officials of the borrowing bank. At that time the reason the loan is being questioned is indicated, the purpose of the loan is ascertained, and a program to reduce or to pay off the loan is agreed upon; or

b. The appropriate Reserve Bank officer discusses the application for credit with officials of the borrowing bank and obtains an adjustment in one or more of the questionable terms and determines the purpose of borrowing prior to approving the loan. These discussions have led to a withdrawal of the application in some cases.

On the other hand, serious problems which the responsible officer is unable to resolve, such as a possible denial of credit, are referred to a committee of officers, the President, or to the Board of Directors for their recommendation. No actual denials were reported by the Reserve Banks. It
appears that such loan applications would be granted and subsequently adjusted, as indicated above, unless, on the basis of the bank's borrowing record, a decision to deny credit had already been made.

Sources of Information

The information used by the Reserve Banks in appraising loan applications is obtained from two general sources: (1) reports regularly submitted by member banks to the Reserve Banks, and (2) information supplied by the borrowing bank in its application for credit, and, in certain cases, in conversations with officials of the borrowing bank.

1. Information obtained from reports of member banks.—All Reserve Banks use examination and call report data for obtaining a general picture of the current condition and changes in assets and liabilities of borrowing banks. These reports appear to be the principal source of information for keeping the Reserve Banks informed as to whether undue use is being made of credit for speculative or other purposes inconsistent with the maintenance of sound credit conditions. Those Reserve Banks which commented on the use of examination reports and reports of condition indicated that the data contained in these reports are studied and analyzed by those responsible for approving loan applications. In all districts except San Francisco, the vice president in charge of bank examinations also serves on the Discount Committee of the Bank.

The weekly condition report obtained from banks in leading cities was mentioned by Richmond, St. Louis, Kansas City, and San Francisco as an additional source of information. Only Kansas City indicated the manner in which the report is used, and that is to furnish members of the Discount Committee with reports of a summary nature concerning the principal banks in leading cities of the district and to supply information as needed on individual borrowing banks.
Current information as to required reserves is obtained from the reports of deposits submitted regularly by member banks for reserve computation purposes.

Reports made by representatives of the public relations and bank examination departments incorporating information obtained in the course of regular visits to State member banks were listed as a source of information by New York, Philadelphia, Cleveland, and Minneapolis.

Special studies and investigations were mentioned as sources of information on the use of Reserve Bank credit by Boston and Minneapolis. Boston did not indicate the nature of these studies, but Minneapolis discussed a report made by the Research Department which was designed to develop information concerning the possibility of a demand for Reserve Bank credit secured by eligible paper.

2. Information supplied directly by the borrowing bank.--The information obtained from the borrowing bank varies from bank to bank. The amount of detailed information obtained from the borrowing bank depends on the type of security offered, the maturity of the loan, and whether the Reserve Bank considers the loan application "routine" or "unusual."

a. Application for credit.--Nearly all Reserve Bank credit today is extended on the member bank's note secured by Government securities, and in these cases a minimum of information is requested from the borrowing bank. Philadelphia, Minneapolis, and Kansas City indicated that no formal application is required for advances on Government securities.

New York, Cleveland, and San Francisco ask for the amount of borrowing from other sources including Federal funds, and in a doubtful situation, the New York Bank would require daily or weekly condition statements.
A condensed report of condition is required by Cleveland, Atlanta, Chicago, St. Louis, and Dallas, while at Dallas the purpose of the loan is also requested.

Atlanta, Minneapolis, Kansas City, and Dallas indicated that additional information is required on the application when the loan is secured by eligible paper or when the application represents an advance under Section 10b, or an advance under the last paragraph of Section 13. Since such credit has represented a very small part of the total at all Reserve Banks in recent years, very little information was given concerning the kind of information required on these applications.

b. Discussions with borrowing banks.--Additional information is obtained by the Reserve Bank on applications considered "unusual" or questionable by means of conversations with officials of the borrowing bank. All of the Reserve Banks indicated that this manner of obtaining information is used, but only a few specified the types of information obtained.
Appendix B

USE OF THE DISCOUNT FACILITY TO MEET SEASONAL NEEDS FOR RESERVE FUNDS

A marked seasonal pattern in the need for reserve funds on the part of the whole banking system results from the seasonal movement in the demand for bank credit and currency. The Federal Reserve has a responsibility for responding to these seasonal swings in reserve needs and thus for moderating the changes in credit conditions that would otherwise result.

Problem of Relying on the Discount Facility for Seasonal Adjustment

The additional need for reserve funds by the banking system resulting from seasonal developments is not the same thing as the sum of the additional seasonal needs for reserve funds on the part of individual banks. For some member banks, peak seasonal needs for reserve funds will occur in a period of general seasonal ease. For other member banks, peak seasonal needs will coincide with that of the banking system.

The sum of the seasonal needs of these latter banks, however, may exceed the seasonal need for supplementary reserves by the banking system. Hence, if all of their seasonal needs for reserve funds are satisfied through the discount window, more reserve funds may be created than are consistent with the Federal Reserve responsibility for responding to the seasonal needs of the entire banking system. An oversupply of reserve funds through the discount window to meet seasonal needs of individual banks may thus render more difficult the conduct of general credit and monetary policy.

If the seasonal borrowing of individual member banks merely supported a proportionate increase in their own loans and deposits or
merely provided for meeting a seasonal outflow of currency, there might be little problem in using the discount mechanism as a primary reliance for meeting seasonal needs. But if, because of a drain of deposits to other banks, deposits of borrowing banks decline or do not rise by the amount of their loan expansion, reserves will be transferred to other member banks without corresponding seasonal need. These funds will be available for loan and investment expansion and for deposit growth in excess of the seasonal needs of the entire banking system.

Liberal Federal Reserve lending to individual member banks for seasonal purposes may also be questioned on grounds of sound banking practice and equity among banks in the use of the discount facility as well as on the basis of the possible oversupply of reserve funds. The bank which is permitted to borrow for a period of several months on grounds of seasonal need may be said to be using Federal Reserve credit in effect as a supplement to its resources. This means of increasing a bank’s resources, moreover, would not be available to other banks which are similar in size and other respects, except that they are unable to justify discounting for seasonal reasons because their loans and deposits are relatively stable throughout the year.

**Seasonal Needs of the Banking System**

The seasonal need for reserve funds on the part of the banking system in the United States increases appreciably late in the year and declines early in the following year. These seasonal swings result from two general economic factors and one factor associated with Treasury finance.

First, there is a marked seasonal pattern in the demand for business and consumer loans as a result of the concentration of activity in a number of important industries late in the year. Notable among these
are retail businesses and industries dealing with agricultural products, which are heavy users of bank credit. Such seasonal increases in credit demands are offset by declines in the first half of the following year. Seasonal variation in these credit demands results in seasonal variation in loans, deposits, and required reserves.

Second, there is a seasonal peak late in the year in the demand for currency to meet holiday and other needs that coincides rather closely with the seasonal peak in the demand for business loans. This increase is offset by a very sharp decline early in the following year. The conversion of deposits into currency requires an increase in reserve funds equal to more than 80 per cent of the amount of the conversion.

A third factor heightening the seasonal shift in the demand for reserve funds is the fact that, under the Mills Plan, Federal Government borrowing has taken on a marked seasonal pattern, with the peak reached in the latter part of the year. To some extent, seasonal movements in Government borrowing requirements may moderate seasonal swings in business loans, as some businesses may be able to meet year-end needs from tax accruals while they increase or maintain borrowings over the following spring in order to make tax payments. The seasonal movement in bank holdings of Government securities resulting from seasonal Treasury borrowing does add, nevertheless, a further complication to the problem of supplying the proper volume of reserves to commercial banks for seasonal needs.

**Seasonal Needs of Individual Banks**

Each member bank has an underlying core of resources which is relatively steady and these are available to meet year-around local credit requirements. Seasonal swings in operations are on top of this underlying core of resources. Individual banks will differ markedly in the extent of
these seasonal swings. The following pages examine some of the typical cases of seasonal movement in the business of individual banks.

Seasonal needs for funds on the part of individual member banks may take the form either of a drain of reserve funds or an increase in reserve requirements. A seasonal drain of reserve funds is commonly found on the part of small banks serving one or a few industries; these banks may have seasonal patterns of loans differing from that of the economy as a whole. A seasonal peak in deposits and reserve requirements at about the same time as the loan peak is more common on the part of large banks serving diversified industries.

Banks dominated by a single industry. If a bank's reserve needs are dominated by a single type of industry which has strong seasonal fluctuations in its own needs for funds, then the bank is likely to lose cash assets at the time of its peak seasonal needs and to regain them subsequently. Its loans would be expected to rise and its deposits to decline as depositors drew on both borrowed and unborrowed deposits to make payments outside the area. The deposit drain would result in an equivalent loss of cash assets. Conversely, the bank's loans would decline and its deposits increase later as payments were made into the area and depositors used part of their funds to repay loans. This sort of development may be found, for example, in banks in agricultural areas and in resort areas.

The period of peak seasonal need for funds on the part of banks dominated by a single industry may or may not coincide with that of the economy as a whole. In some of the most common cases it will differ.

The timing of the agricultural growing season, for example, results in an increase in loans and a decrease in deposits at many agricultural banks in the spring as farmers finance their planting and
meet their living costs. Deposits are built up and loans are repaid as crops are harvested and sold in the fall. The precise timing of the seasonal movements for banks in agricultural areas, however, depends not only on the particular crop of the area but also on the method of financing its production and sale. In cotton-raising areas the pattern of needs is similar to that described above; cotton is harvested in the late summer and early fall and is generally sold to commodity dealers soon thereafter. Loans of banks in cattle-fattening areas, on the other hand, increase late in the year and remain high until spring.

Summer resort areas, like many agricultural areas, experience loan increases and deposit drains in the spring; their loans decline and their deposits increase during the summer. Winter resort areas, on the other hand, have a loan increase and deposit decline in the summer and fall and a loan decline and deposit increase in the winter and early spring.

Banks with diversified customers. If a bank is large and has a diversified group of customers, the seasonal movement of its loans and deposits is likely to coincide closely with that of the economy as a whole. Its seasonal problem is likely to consist largely of an increase in required reserves rather than a loss of cash resources at the period of its peak seasonal needs. The diversity of its customers would be expected to bring about a seasonal pattern similar to that of the economy as a whole.

These banks have many customers in those lines, such as commodity dealing, food processing, and trade, in which the demand for loans increases late in the year. They generally make relatively few loans in fields like agricultural production in which the pattern of seasonal demands is strikingly different.
The proceeds of loans by a large bank with diversified customers may be left on deposit or redeposited by workers, merchants, or stockholders to whom payment is made. Although some of the proceeds of a given bank's loans will be used to make payments outside the area, the bank will in turn benefit from receipt of deposits generated by loan and investment expansion of other banks. Cash assets are undoubtedly lost by some large and diversified banks, especially those that are lending a substantial amount to commodity dealers and food processors that are making payments outside the area, but many such banks are faced only with the problem of an increase in required reserves.

Effect of correspondent banking relationships. No consideration of the seasonal reserve needs of banks would be complete without a consideration of correspondent banking relationships. To the extent that individual small banks meet seasonal reserve needs by borrowing from their city correspondents, or by drawing down their balances with them, they pass on their own seasonal pressures to their correspondents. In many cases the peak needs of country and city banks dovetail, and city banks are in a position to meet country bank reserve pressures easily. On the other hand, in some cases city banks seem to need increased reserve funds to meet the seasonal needs of their nonbank customers at the same time that they have to meet a loss of cash assets as a result of their correspondent bank activity.

For the banking system, however, and for most major classes of banks, correspondent relationships appear to ameliorate rather than to aggravate the seasonal problem. Seasonal movements in interbank loans are not consistent, and in any event the magnitude of such loans is small. Interbank deposits are considerably larger and show considerably larger
fluctuations in dollar amounts over the year. Their seasonal movement, however, is similar to that for total customer loans and for total demand deposits, with an increase late in the year and a decline early in the following year. Thus city banks actually gain funds at the period of their peak seasonal need as a result of correspondent relationships.

The building up of deposits with correspondents late in the year is probably the result of two different sets of factors. First, it is known that many banks in agricultural areas which have favorable clearing balances late in the year do not invest fully their excess funds, but instead permit balances to pile up with correspondents and draw on them only as they are needed in the following year. Second, other banks with increased payments to make in regional or national money markets may find it convenient to increase their balances in these centers even though they are not in receipt of excess funds.

Seasonal Needs of Individual Banks vs. Seasonal Needs of the Banking System

The very nature of economic activity in a complex economy results in marked differences in the pattern of seasonal needs of different industries and hence of the banks serving these industries. Different types of activity are affected differently by seasonal changes in climate and in consumer demand. Moreover, the relation of the various types of activity to each other necessitates that the periods of peak needs for funds on the part of some industries precede or follow those on the part of other industries. For example, the peak needs for loans on the part of dealers in agricultural commodities occur when the dealers are making payments to farmers and thus permitting the latter to build up deposits and repay loans. In many cases banks which have marked differences in the pattern of their seasonal needs because of the difference
in the nature of their customers may be closely related by correspondent relationships or otherwise.

Even when the seasonal pattern of reserve needs of individual banks coincides rather closely with that of the banking system as a whole, the sum of the seasonal needs of individual banks may be expected to exceed the needs of the economy as a whole. This fact arises from the nature of bank reserve requirements. The reserve needs of an individual bank lending to finance purchases outside the area may equal its loan expansion, or may even exceed it if depositors are drawing down unborrowed deposits at the same time. Except to the extent that a currency drain exists, however, the needs for the banking system as a whole will be equal only to the reserve requirements behind the increased deposits resulting from the loan expansion. As deposits and reserves are drawn from one bank, they will generally be redeposited in another bank, which will thus find its reserves increased more than its reserve requirements.

It has already been noted that many banks with seasonal loan patterns corresponding with that of the banking system gain deposits and reserves as a result of the expansion of loans and investments on the part of other banks at the same time that they are losing deposits and reserves as a result of their own credit expansion. Any realistic definition of the seasonal needs of such banks would have to take account of these movements. Account would also have to be taken of any building up of correspondent balances with these banks that typically takes place.

Despite the fact that many banks receiving deposits and reserves as a result of expansion by other banks can use them to meet their own seasonal needs, others receiving them may be at a period of seasonal ease, and hence may seek other uses for the funds. Excess funds supplied by discounting for seasonal purposes may thus constitute a marginal supply
of reserve funds which makes it very difficult for the Federal Reserve to exercise any effective control over the total supply of reserves.

**Federal Reserve Role in Meeting Seasonal Monetary Needs**

It was partly to make possible seasonal expansion and contraction in the supply of reserves and currency that the Federal Reserve System was established. Prior to the establishment of the Federal Reserve System the reserve and currency supply was highly inelastic, and seasonal increases in the demand for bank credit and currency resulted in a growing tightness of the credit market and at times in banking crisis. The Federal Reserve was expected to be able to permit bank reserves and currency to expand and contract in accordance with seasonal needs; and despite changes in the pattern of seasonal needs and the means of adjusting to them since that time, its responsibility to respond to seasonal needs has not been questioned.

Because the increase in the supply of money accompanying purely seasonal credit expansion is offset by a subsequent decline and because the Federal Reserve has an established responsibility for meeting seasonal monetary needs, there has been a tendency to assume that meeting the seasonal needs of individual banks through the discount window can never conflict with the general objectives of System policy. As made clear earlier, however, the sum of the positive reserve needs of individual banks can exceed in practice the needs for funds on the part of the entire banking system. If Federal Reserve credit is supplied through the discount window to meet these individual needs, the total supply of reserves may exceed the seasonal needs of the banking system as a whole and the excess may encourage undesirable monetary expansion and subsequently prove hard to recapture.
Because of the lack of identity of seasonal reserve needs of individual banks with seasonal monetary needs of the banking system, it is important for the System to have a carefully thought-out program for the use of its instruments in meeting seasonal needs for Federal Reserve credit. A more effective regulation of the credit and monetary flow seems likely to result if the System normally relies on open market operations for responding to seasonal monetary swings of the banking system. By maintaining an adequate portfolio of short-term Government securities and other money market paper which can be sold as needed, individual member banks in providing for ordinary seasonal requirements may assure themselves of a satisfactory access to funds available in the credit market.

The open market method of meeting the System's seasonal responsibilities cannot be counted on to cope with all seasonal reserve problems of individual member banks, but it would work to limit the use of the discount facility to requirements which in the view of the Reserve Bank could not reasonably be anticipated and met by the use of the member bank's own resources. The adoption of a positive standard for seasonal use of the discount facility would be in line with the System's general credit and monetary responsibilities as well as with equity among banks in access to and use of the discount facility. Since one of its purposes would be to help cope with the problem of continuous borrowing growing out of seasonal reasons, it would generally assist the System in maintaining a system of strong and responsive individual member banks.

**Individual Bank Handling of Foreseeable Seasonal Reserve Needs**

A key question is whether individual member banks can adequately meet local year-around needs for credit and still administer their assets so as to be in a position to provide for foreseeable seasonal swings out of their own resources. As indicated previously, there are marked
differences in the bank to bank size of seasonal demands. Nevertheless, the proportion of resources that is stable is substantial for even the highly seasonal bank.

Typically, banks hold a considerable amount of deposits which either show little seasonal fluctuation or else show a seasonal pattern differing from that of the seasonal activities which dominate the pattern of the bank's reserve needs. Local demands for credit, moreover, are not all concentrated at a particular period of the year. For example, most banks in agricultural areas make a considerable amount of loans to retail trade; such loans offset in part the seasonal demand for loans to farmers. Then again bank lending to commodity dealers is generally characteristic of large banks having a diversified customer clientele; the seasonal movement in commodity loans of such banks, while coinciding with the seasonal movement of loans in general, may be counteracted by the action of other types of loans having offsetting seasonal movements. In addition, nearly all banks hold a considerable amount of Government securities not only at periods of seasonal ease but also on a continuing basis.

Member banks can meet seasonal needs for reserve funds arising from deposit declines or increases in loans to seasonal-borrowing industries in several ways besides borrowing from the Federal Reserve. Where cash asset holdings (deposits with correspondent banks and excess reserves with the Reserve Banks) are sufficient, seasonal needs may be met by drawing down these assets. Where cash asset holdings are inadequate, seasonal reserve needs may be met by the sale or run-off of liquid assets. Short-term Government securities, which have little risk of capital loss, are particularly appropriate for this purpose. Under the pattern of
System operation assumed by the Committee, the Federal Reserve at periods of seasonal pressure for the banking system would be supplying sufficient funds to the market to take care of the aggregate seasonal drain. This action by the System, in keeping purely seasonal pressures from being reflected unduly in the national money market, would foster market conditions that would make it possible for individual banks to obtain needed reserve funds by selling short-term Governments on satisfactory terms.

There are grounds for believing that the undue seasonal reliance of some member banks on discounts goes back more to inadequate holdings of cash assets and short-term Government securities than to the pressure of strong seasonal movements in deposits and loans. It would appear that if such banks regularly invested funds accruing to them during periods of seasonal ease in short-term securities rather than in less liquid assets, their own resources would provide for their foreseeable seasonal requirements under most circumstances. If this practice were generally followed, any bank with seasonal reserve needs in excess of its anticipation could properly meet these needs through temporary use of the discount facility. Member bank needs for extended advances would then be limited for the most part to instances of extraordinarily large deviation from usual seasonal developments.

The above discussion has been concerned with the broad problem of seasonal borrowing and the development of a general philosophy for handling the bulk of the cases arising in this area. It has not endeavored to deal, of course, with those unique situations which may arise in connection with a few member banks. Such exceptional seasonal borrowing
situations by definition fall outside the scope of general rules. Their separate handling must be determined by the individual Reserve Bank on the basis of a rule of reason applied in the light of the special facts involved.
THE PROBLEM OF DEFINING AND IDENTIFYING CASES OF CONTINUOUS USE OF THE DISCOUNT FACILITY

A problem of continuous use of the discount facility has long harassed administration of Federal Reserve discount policy, but the issues of the continuous borrowing problem have not been sharply drawn. There is apparent consensus regarding the undesirability of such a practice, except under unusual and exigent circumstances, but no full agreement as to how to define the malpractice or as to the standards by which it is to be identified.

Objections to Continuous Borrowing

Perhaps the most useful way to approach the problem of defining and identifying cases of continuous borrowing where unusual and exigent circumstances are absent is through consideration of objections to such borrowing on which System consensus is clearest. Within the System, there are generally felt to be four important objections to continuous borrowing:

(a) The conversion of the Federal Reserve role with respect to individual member banks from one of temporary and emergency assistance to one of semipermanent investment;

(b) The concentration of a Reserve Bank's lending power in prolonged credit extensions to an individual or a few individual banks;

(c) The reflection on the soundness of individual borrowing banks of large and continuous indebtedness and the dangers this may entail to the maintenance of banking stability;

(d) The injection of reserves into the banking system in a manner at variance with over-all credit and monetary policy.
By considering continuous borrowing in terms of these objections a good deal can be learned about the problem of its meaning.

Implications of the "semipermanent investment" and "concentration of lending power" objections.--Borrowing enlarges a member bank's resources by adding to its reserve account and enabling it to hold more earning assets than otherwise. A bank may resort to borrowing in preference to disposing of a marketable asset either because of convenience or because of lower total direct and indirect cost.

Aside from perhaps emergency reasons, the System has no defensible stake—implied either by law or by custom—in becoming a continuing or extended creditor of any one bank, however much the borrowing bank might profit from the additional earning assets retained with the help of such credit. According to accepted principles governing discounting, the discount facility is normally available to member banks for meeting temporary reserve needs pending more basic adjustments in their operating positions. In addition, the facility is available in emergency situations, on the basis of the lender-of-last-resort principle, for such periods as may be necessary to prevent a lack of liquidity from becoming a cause of insolvency.

Continuous discounting by individual banks, except in unusual circumstances, has the danger of placing the System in the untenable position of having a semipermanent investment in a number of individual banks. It also has the danger of absorbing, in a use incompatible with the primary purposes of the discount function, an undue part of the credit which the System can reasonably and safely
make available. Lastly, it operates to reward those aggressive banks which are willing to use the discount facility for profit opportunities at the expense of banks which follow more conservative practices and meet their reserve needs through asset adjustments.

Most member banks recognize the inappropriateness of such borrowing from Reserve Banks. More aggressive banks may from time to time take advantage of the discount facility by borrowing as much as possible for as long as possible. Unless the System takes positive action in these cases, it becomes in effect a party to doubtful and unsound practices on the part of such banks.

Implications of the "banking soundness" objection.—The System has a clear responsibility under the Federal Reserve Act to take steps directed at maintaining the soundness of the banking structure. System operating experience over the years has made clear that a system of unit banks, because of the close interdependence of its members, is fundamentally little stronger for meeting the strains of adverse financial and economic trends than the strength of the individual units of which it is composed. Experience has also made clear the essential unsoundness, from a going-bank and depositor-safety standard, of reliance on borrowed funds of prior creditor status to supplement a bank's resources. For this reason, it is essential that member banks keep in a position to meet operating needs from their own resources rather than relying on System assistance to supplement an inadequate capital structure.
Implications of the "reserve" objection.—From the standpoint of the banking system as a whole, discounting by individual banks leads to an injection of reserves, which in turn can support a multiple expansion of bank credit and deposits. The supplying of reserves through temporary borrowing pending more permanent adjustment does not seriously hamper System credit policy. The total of such borrowing, which shifts from bank to bank as each bank first becomes indebted and then passes the indebtedness on to other banks through asset adjustments, cannot rise above some minimum amount without becoming significantly restrictive on commercial bank lending and investing activity. Indeed, the over-all level of such discounting depends in large measure on other credit actions of the System.

If individual banks are willing to borrow continuously, however, then the System runs the risk of finding itself in the position of supplying reserves to the banking system at the initiative of individual member banks which feel no compulsion to liquidate their indebtedness through asset adjustments. The reserves supplied in this manner may seriously hamper the implementation of System credit policy.

In a consideration of the effects of continuous borrowing on the reserve position of the banking system, it is desirable to review the mechanism by which such reserves are released. In most cases, of course, the specific reserves borrowed are not redistributed through the System; they are simply held in the borrowing bank's reserve account to redress a previous reserve loss. But if that reserve loss stemmed
from any action other than a withdrawal of currency or payment to a Reserve Bank, some other bank must have experienced a corresponding reserve gain. Whether there is a net increase in the System total of bank reserves, therefore, depends on what the recipient bank does with its newly-acquired reserves.

If the recipient bank uses the funds to repay borrowing, or to avoid borrowing previously expected to be necessary, then there is no net increase in bank reserves above the total which would otherwise have obtained. A similar result would be reached if the recipient bank transferred its excess reserves (by a sale of Federal funds, an increase in its correspondent balance, or the purchase of a marketable asset) to another bank desiring reserves in order to repay or avoid borrowing.

On the other hand, if the recipient bank employs the funds received as a base for loan expansion or exchanges them for other assets through channels which do not quickly lead back to the Federal Reserve, then a net increase in reserves of significant duration will have occurred and a consequent loan and deposit expansion will have begun.

It is important to note that it is not the banks which gain funds from borrowing banks through clearing balances that are primarily affected by the decisions of the latter banks to borrow or not to borrow. The original transfer of reserves is generally independent of action taken by the borrowing bank. The banks which are affected by the decision of a reserve-losing bank to borrow more or less continuously are those which would lose reserves if the borrowing bank made its adjustments through the market rather than through discounting
with the Federal Reserve. Only rarely are the banks gaining reserves from reserve-losing banks those that would be influenced by the reserve-recovery operations of the latter. In general, it is banks in the central money centers that are likely to be most influenced by the decisions of reserve-losing banks to borrow or not to borrow.

In the long run a reserve-losing bank may curtail its loan extensions with the aim of reducing the total of net deposit withdrawals and eventually turning clearing balances in its favor. The ultimate return flow of reserves in this case could come from anywhere within the banking system. More immediate and certain alternatives to borrowing are the drawing down of correspondent balances or the sale of easily marketable assets (presumably Treasury bills) in the money market. Stop-gap assistance could be obtained by purchases of Federal funds, if available. Each of these three latter measures would in most cases pull reserves out of the central financial markets—or, what amounts to the same thing, would absorb reserves which would otherwise have gravitated to the central markets.

Basically, the expansionary opportunities available to the reserve-receiving bank are inevitable in a free-transfer financial system. What borrowing, and particularly continuous borrowing, does is to mitigate the compensating contractive influences upon the reserve-losing bank and ultimately upon banks in money market centers. The result is a net increase in the reserves of the banking system as a whole and the possibility of multiple expansion of bank credit and deposits.
Definition and Identification of Continuous Borrowing

From the foregoing discussion, it follows that a useful definition of continuous borrowing must have content in terms of these objections. In order to be meaningful in terms of that discussion, it would seem that the definition of continuous borrowing needs to take into account not only cases of uninterrupted indebtedness over an extended period of time but also frequent, interrupted borrowing that provides a member bank with reserves in all, or a considerable proportion of, consecutive reserve periods. Such a definition is not without its practical complications where applied to concrete cases, and these are explored below.

Cases of extended indebtedness in which unusual and exigent circumstances are not a consideration, are readily identified as continuous borrowing. The administrative question with respect to such cases is at what point in time the borrowing becomes continuous. In a discount policy which emphasizes 15 days as the maximum maturity for temporary borrowing, this question would arise first at the time of the first renewal; the issue would sharpen on further applications for extension. It would be a matter for Reserve Bank discount administration to decide, in the light of all the circumstances of the individual borrowing, when an indebtedness should be regarded as continuous, thus calling for special review and consideration. Consultation and exchange of information between the Reserve Banks could be helpful in arriving at such System-wide consistency of standards as would prove
practicable in view of the economic differences between Reserve districts.

Cases in which member banks are in and out of debt from day to day over successive or nearly successive reserve periods are not so readily identifiable as continuous borrowing; superficially they are not continuous at all. A little reflection, however, will show that cases of repetitive borrowing over successive reserve periods differ little in effect from cases of extended indebtedness. Reserve requirements are based on average daily balances over a seven-day or over a half-month period. Hence, there is no rigid requirement concerning the quantity of reserves to be held on any single day, and excess reserves obtained by borrowing on a one- or two-day basis can be used to offset reserve deficiencies over the rest of the reserve period. From the standpoint of the addition to a reserve city bank's resources, as an example, there is no difference between a one-day loan for 70 million dollars and a seven-day loan for 10 million, so long as all the days are in the same reserve period. In each case, the borrowing will have been large enough to permit the bank to hold an average of 10 million dollars more of earning assets over its reserve period than if there had been no borrowing.

From this relationship it follows that, from the standpoint of the continuity of reliance on the Federal Reserve, there is no substantive difference between a reserve city bank which remains in debt for 10 million dollars for ninety days and a similar bank which borrows
70 million for one day in each of 13 consecutive reserve periods. Both banks are patently to be regarded as continuous borrowers for the ninety-day period, irrespective of the reasons why one procedure of borrowing was followed in one case and a different procedure in the other.

The fact that repetitive borrowing is logically to be included as a form of continuous borrowing makes necessary the development of some reasonable empirical standard for judging the number of reserve periods that a bank may borrow successively before it is to be considered a continuous borrower. This basic standard needs to be consistent with that adopted for identifying extended, uninterrupted indebtedness as continuous borrowing. The application of such a standard, however, is by no means free of difficulty.

The chief complication involved in identifying repetitive borrowing as continuous borrowing results from the imperfect predictability of the reserve flows to which member banks are subject, and the consequent possibility that some member banks may chance to be in debt at least once in a succession of reserve periods due to causes beyond their own control. Thousands of transactions add to and subtract from the typical member bank's reserve account each day. Although the regularity of reserve flows varies among banks, any bank is subject to the hazard that an unexpected net reserve drain (or a smaller than expected reserve gain) may appear late enough in a reserve period to make it inconvenient, costly, or even impossible to take redressing
action during the time remaining in the period. The fact that this is possible, of course, is one of the reasons why the borrowing privilege is available.

Such chance combinations of late-period reserve movements could conceivably lead a bank to unplanned borrowing from its Reserve Bank in several reserve periods in a row. It may be difficult to judge whether borrowing for a few days in each of several successive reserve periods is the result of such chance factors or whether, on the other hand, it is intentional or complacent in the sense that the bank does not attempt to make other adjustments to basic changes in its reserve position. With each successive period in which borrowing occurs, however, the probability that the borrowing stems from inadvertent causes obviously decreases (although it never disappears). Consequently, if a bank borrows at least once in each of a number of consecutive reserve periods, there exists a presumption that it is using this means deliberately to avoid more basic adjustments in its position and hence that the borrowing is continuous in the sense indicated here.

Still further complexity of the continuous, repetitive borrowing concept is encountered in considering cases of banks which borrow in a large proportion of reserve periods over a period of time, but which have occasional debt-free periods. Such banks may be overextended on the basis of their resources in the same sense as banks that are in debt in each successive reserve period. The debt-free period of these banks may be the result either of unexpected late-period reserve gains
or of action taken to free themselves from indebtedness periodically
in order to avoid review as continuous borrowers. While such instances
may be difficult to identify, the definition of continuous repetitive
borrowing needs to take them into account.

It may be concluded that it is desirable to define continuous,
repetitive borrowing as borrowing in a sufficient concentration of re­
serve periods as to make it probable that such borrowing is intended
or complacent rather than inadvertent. The words intended or complacent
in this usage, of course, would include instances where a bank's money
position is managed in a way that makes it difficult to avoid borrowing
over a succession of reserve periods. The specific guideposts for
identifying such borrowing can be established only on the basis of
broad discount experience of individual Reserve Banks and discussion
among the Reserve Banks. It is enough to say here that such identifi­
cation requires some standard of reasonableness based on experience.

The definition of continuous borrowing is independent of the
amount borrowed. In considering the borrowing record of individual
banks, however, some attention would also have to be given to the rela­
tionship of borrowing to required reserves and to bank capital. The
amount borrowed is one piece of evidence to be taken into account in
judging whether the borrowing is intended or complacent. The larger
the amount of borrowing in relation to required reserves and capital
(assuming no unusual and exigent circumstances to be associated with it),
the greater the presumption that borrowing is planned or complacent and
not the result of a succession of chance developments. Further evidence
as to the purpose or occasion for borrowing may be obtained by studies of changes over time in certain items in the bank's balance sheet, including deposits, customer loans, and money market assets as well as borrowings, reserves, and capital accounts.

Finally, identification of cases of continuous borrowing needs to take into account use of the regulative provision which allows a bank to incur up to a two per cent deficiency in one reserve period without penalty, provided the deficiency is made up in the ensuing period. This provision permits the avoidance of borrowing to that extent, and, from one standpoint, use of this privilege could be considered the equivalent of a Federal Reserve loan to the member bank. The carry-over of a reserve deficiency, therefore, needs to be taken into account in the same way as discounting during the period in developing the borrowing record of an individual member bank.

**Conclusion**

This analysis of the problem of defining and identifying continuous borrowing points to the conclusion that a member bank borrowing one or two days in each of successive or nearly successive reserve periods can be as much a continuous borrower as a bank that maintains uninterrupted indebtedness over a number of reserve periods. The fact that one method of indebtedness was chosen by a member bank rather than the other is not pertinent to the definition. In order to identify continuous borrowing the individual Reserve Bank must have standards of evidence and standards of continuity. A rationale for such standards
is indicated in the discussion, but it is recognized that these standards must have a quality of reasonableness that can only be given specific content in terms of actual discount experience.

The significance of defining continuous borrowing to include both uninterrupted indebtedness over a period of time and frequent borrowing over successive reserve periods stems from the major objections to such borrowing generally recognized by the System. These objections have equal force whether funds are supplied to member banks through uninterrupted borrowing or through repetitive borrowing over a succession of reserve periods. If only uninterrupted indebtedness were to be frowned upon as continuous borrowing, then the possibility of borrowing through successive one- or two-day discounts would provide a loophole through which aggressive banks could avoid any regulative standard directed at continuous borrowing.
APPENDIX D

SUGGESTED REVISION OF REGULATION A

There is attached a draft (dated 3-12-51) of a suggested revision of Regulation A which has been prepared in connection with the current study of the discount mechanism. There is also attached a document which shows the textual changes which would be made in the present Regulation by the proposed revision.

As an aid to further consideration of this matter, there follows a series of comments and explanations with respect to the principal changes which would be made in the existing Regulation A by the suggested revision.

1. New Statement of General Principles

The most important change would be the inclusion of a new section 1 entitled "General Principles". Since these principles are fully discussed in the Report itself, no further comments seem necessary here.

2. Advances on Government Obligations

Section 2 of Regulation A as now in effect authorizes advances to member banks on Government obligations for periods not exceeding ninety days, with a footnote explaining that, while paragraph 8 of section 13 limits maturity to fifteen days, paragraph 13 authorizes maturities of not exceeding ninety days on advances to "corporations" including banks.

The proposed revision would restore the language of this section to the form in which it read prior to 1942, so that the text of the section would follow literally the eighth paragraph of section 13 by authorizing advances to member banks on Government obligations with maturities not exceeding fifteen days (except that references to bonds of the Farm Mortgage Corporation and the Home Owners' Loan Corporation would be covered by a footnote). However, there would be added a new footnote which would refer to the authority of the Reserve Banks under the thirteenth paragraph of Section 13 to make advances on Government obligations to corporations, including banks, with maturities not exceeding ninety days and which would, at the same time, state that ordinarily the maturity of temporary borrowings by member banks should be limited to fifteen days. It has been suggested that this change would make it easier, if desired, to differentiate between fifteen-day and ninety-day advances and to fix a higher interest rate with respect to such advances in excess of fifteen days.
3. Advances on Eligible Paper

The present provisions of section 2 of the Regulation authorize advances to member banks on their notes secured by eligible paper with maturities not exceeding ninety days. No change would be made in this language but, in keeping with the change made in the provisions with respect to advances on Government obligations, a footnote would be added calling attention to the general principle set forth in the new section 1 that ordinarily the maturity of temporary borrowings by member banks should be limited to short periods.


In the present Regulation, advances on eligible paper are mentioned before advances on Government obligations, both in the introductory paragraph and in section 2 of the Regulation. The proposed revision would reverse this order of mention in both places on the theory that advances on Government obligations are now of more importance and deserve more emphasis than advances on notes secured by eligible paper.

5. Reversal of Order of Provisions Relating to Discounts and Advances

For somewhat similar reasons, the proposed revision would reverse the traditional order of arrangement under which section 1 of the present Regulation relates to discounts, while section 2 relates to advances. In the revision, after the new section 1 with respect to general principles, section 2 would cover advances to member banks and section 3 would cover discounts. In conformity with this change, the title of the Regulation would be changed to refer first to advances rather than discounts.

6. Advances under Section 10(b)

Subsection (d) of section 2 of the present Regulation enumerates various classes of assets which may be accepted as collateral for section 10(b) advances. It is recognized that in 1937 when the Regulation was last revised, there may have been adequate reason for an enumeration of such classes of paper. However, the classes of paper listed do not cover several classes which have grown up since 1937, and might as well be included, e.g., obligations under Title VI and perhaps other titles of the National Housing Act, term loans, etc. It is believed that there is no necessity at this time for such a listing of acceptable classes of paper and that such a listing may in fact be misleading. Accordingly, the revision would omit subsection (d) of section 2 of the present Regulation.
7. Marginal Collateral

Subsection (d) of section 3 of the present Regulation, relating to additional or marginal collateral, contains a sentence requiring a Federal Reserve Bank to explain the circumstances of any discount or advance with respect to which the required collateral exceeds 25 per cent of the amount of the paper discounted, or 125 per cent of the amount of the advance, as the case may be. This sentence would be omitted in the proposed revision as no longer necessary.

8. Amount of Credit Extended on Government Obligations

The proposed revision would also omit the present subsection (e) of section 3 of Regulation A which requires a Reserve Bank to explain the circumstances of any advance on direct or fully guaranteed obligations of the United States where the amount of the advance is less than the face amount of such obligations. To the extent that this provision implies that Federal Reserve Banks may make advances on Government obligations at less than par, it is inconsistent with the general policy followed by the System since 1939 that all such advances shall be made at par. On the other hand, it is recognized that the omission of this subsection might be interpreted, although erroneously, as representing a change in Federal Reserve System policy in this respect; and, if the provisions are omitted as suggested, it might be desirable to state in an accompanying public announcement that no change in present policy is intended. This point may require further consideration.

9. Advances to Nonmember Banks

The proposed revision would include a new section 6, authorizing any Reserve Bank to make advances to a nonmember bank on the security of direct obligations of the United States in unusual and exigent circumstances and where the nonmember bank can show its inability to obtain the credit from correspondent or other banks or from other usual sources of credit.

Because of the inclusion of this new section regarding advances to nonmember banks, the proposed revision would include also a change in the title of the Regulation so that it would refer to discounts for, and advances to, "banks", rather than "member banks". For similar reasons a new clause has been inserted in the introductory paragraph of the Regulation referring specifically to advances to nonmember banks on their notes secured by direct obligations of the United States.

It should be noted that the proposed revision, like the present Regulation A, contains no reference to the authority in paragraph 13 of the Federal Reserve Act to make advances to individuals, partnerships,
or corporations other than banks. It has been suggested that this matter
might be covered in a letter to the Federal Reserve Banks.

10. Information Which May Be Required by Federal Reserve Banks

The proposed revision would substitute for subsection (c) of present
section 3 of the Regulation a new paragraph which would authorize a Federal
Reserve Bank to obtain from its member banks such information as might be neces-
sary, not only to determine whether speculative use is being made of bank credit,
but also in order to determine compliance with any of the general principles
set forth in section 1 of the Regulation.

11. Bankers' Acceptances

The present section of the Regulation relating to bankers' acceptances
would be eliminated, but the substance of that section would be incorporated
in a new subsection in section 3 of the proposed revision. This would be a
change in form only and not a change in substance.

12. Appendix Recommendations with Respect to Real Estate Loans and Loans
   on an Installment Basis

The proposed revision would omit the recommendations contained in
the Appendix to the present Regulation with respect to minimum standards for
real estate loans and for installment paper used as collateral for advances
to member banks. If these recommended standards, which were drafted in 1937,
should be retained in the Appendix, they would require modification, and the
Staff doubts whether their inclusion, even if modified, would serve any useful
purpose.

13. Other Changes

The present prefatory statement of "General Principles" would be
omitted, since it would be superseded by the new section 1 of the Regulation.

For technical reasons, the reference to Regulation B in subsection (a)
of section 2 of the present Regulation would be changed to refer to the Federal
Reserve Act.

The new section 7 is changed to require the Board's permission for
discounts for Federal Intermediate Credit banks.

Appropriate changes are made in the revision in the numbering of
sections, in cross references to sections, and in the table of contents.
Some changes would, of course, be necessary in the statutory provisions which
would be set forth in the Appendix.

Attachments
APPENDIX D-1

REGULATION A

ADVANCES TO AND DISCOUNTS FOR BANKS BY

FEDERAL RESERVE BANKS

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REGULATION A

Revised Effective ______. ______

ADVANCES TO AND DISCOUNTS FOR BANKS BY
FEDERAL RESERVE BANKS

INTRODUCTION

This Regulation is based upon and issued pursuant to various provisions of the Federal Reserve Act, the most important of which, together with related provisions of law, are published in the Appendix hereto. The Regulation is applicable to the following forms of borrowing from a Federal Reserve Bank: (1) advances to member banks on their own notes secured (a) by direct obligations of the United States, by paper eligible for discount or purchase by Federal Reserve Banks, or by obligations of certain corporations owned by the United States, or (b) by other security which is satisfactory to the Federal Reserve Bank; (2) discounts for member banks of commercial, agricultural and industrial paper and bankers' acceptances; (3) advances to nonmember banks on their own notes secured by direct obligations of the United States; and (4) discounts for Federal Intermediate Credit banks.

SECTION 1. GENERAL PRINCIPLES

The basic objective underlying Federal Reserve credit policy is the advancement of the public interest by contributing to the greatest extent possible to economic stability and growth. The Federal Reserve does this largely by influencing the supply, availability, and cost of
reserve funds to the banking system. The Federal Reserve may take the initiative in providing or absorbing reserve funds in accordance with the needs of the banking system as a whole; this is done through open market operations and at times through changes in reserve requirements. On the other hand, an individual member bank may take the initiative in obtaining reserve funds by borrowing at the Federal Reserve Banks, at discount rates which are raised and lowered by the Federal Reserve from time to time in accordance with the credit and economic situation. This borrowing facility is designed primarily to permit an individual member bank to meet its temporary or emergency needs for reserve funds. The member bank is thereby enabled, pending other adjustments in its reserve position, to continue to accommodate the legitimate credit needs of commerce, industry, and agriculture. However, borrowings by individual banks add to the supply of reserves of the banking system as a whole, and therefore the manner and extent of the use of the borrowing facility have an important bearing upon the effectiveness of System credit policy.

Accordingly, in considering applications for credit, a Federal Reserve Bank must have regard not only to statutory and regulatory requirements with respect to the eligibility of the paper offered for rediscount or as collateral for advances, but also to certain general guiding principles, particularly those set forth below, which have been established by Congress in the law itself or by the Board of Governors pursuant to its authority to define the conditions under which such credit accommodations may be extended. These principles take account
of the obligation of the Federal Reserve Banks, as stated in the law,\textsuperscript{1} to give due regard to the claims and demands of other member banks, the maintenance of sound credit conditions, and the accommodation of commerce, industry, and agriculture. Access to the credit facilities of the Federal Reserve Banks is a privilege of membership in the Federal Reserve System which must be considered in the light of these principles:

(1) Due regard must be given to the effect of any extension of credit upon the maintenance of sound credit conditions, both as to individual institutions and as to the economy generally. Accordingly, consideration should be given to the effect that the granting or withholding of credit accommodations may have upon the applicant member bank, its depositors, and the community and its credit needs, and whether the member bank is conducting its operations in a manner consistent with sound credit conditions.

(2) Federal Reserve credit should normally be extended for short periods to meet temporary credit needs of member banks. (For example, extension of Federal Reserve credit is appropriate in order to enable a member bank to adjust its asset position because of such developments as a temporary loss of deposits or to assist a member bank in meeting requirements for seasonal credit which cannot reasonably be anticipated and met by use of the member bank's own resources.)

\textsuperscript{1} See paragraph \textsuperscript{1} of section 14 of the Federal Reserve Act set forth at p. \textsuperscript{1} of the Appendix to this Regulation.
(3) In order to enable member banks to meet unusual and exigent situations, Federal Reserve credit should be extended for as long a period as may be deemed necessary — whether such situations result from a national economic emergency, or from exigent regional or local conditions, or, in certain situations, from an emergency involving only the particular member bank.

(4) While unusual and exigent circumstances or special local economic needs may justify continuous borrowing by a member bank over a considerable period of time, under ordinary conditions continuous use of Federal Reserve credit by a member bank so as in effect to increase its resources, whether by long-term borrowing or by frequent short-term borrowings, would not be an appropriate use of Federal Reserve credit.

(5) In determining whether to grant or refuse credit to any member bank, the Federal Reserve Banks are required by the law to consider the general character and amount of the loans and investments of the member bank and whether the bank is extending an undue amount of credit for speculative purposes in securities, real estate, or commodities.

(6) Federal Reserve credit should not be extended where it appears that the member bank's principal purpose is to profit from rate differentials or to obtain a tax advantage.

(7) The law permits only such extensions of Federal Reserve credit as may be "reasonably and safely made"; and the
acceptability of paper offered for rediscount or as collateral for advances must be determined in the best judgment of the Federal Reserve Bank in accordance with the provisions and objectives of the Federal Reserve Act and this Regulation.

(8) The Board of directors of each Federal Reserve Bank is required by law to administer the affairs of such Bank fairly and impartially and without discrimination in favor of or against any member bank or banks. Accordingly, in passing upon a member bank's request for credit, due regard must be given to the claims and demands of other member banks.

Subject to consideration of the principles above stated and to other provisions of this Regulation, credit accommodations may be extended pursuant to any of the various provisions of the law authorizing extensions of such credit. In passing upon requests for credit accommodation, the directors and officers of the Federal Reserve Bank should give consideration to all of the principles stated above, together with any other factors which may be pertinent.

SECTION 2. ADVANCES TO MEMBER BANKS

(a) Advances on Government obligations.—Any Federal Reserve Bank may make advances, under authority of section 13 of the Federal Reserve Act, to any of its member banks for periods not exceeding
fifteen days\(^2\) on the promissory note of such member bank secured (1) by the pledge of bonds, notes, certificates of indebtedness, or Treasury bills of the United States, or (2) by the pledge of debentures or other such obligations of Federal Intermediate Credit banks having maturities of not exceeding six months from the date of the advance.\(^3\)

(b) Advances on eligible paper.—(1) Any Federal Reserve Bank may make advances, under authority of section 13 of the Federal Reserve Act, to any of its member banks for periods not exceeding ninety days\(^4\) on the promissory note of such member bank secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for discount by Federal Reserve Banks under the provisions of this Regulation or for purchase by such banks under the provisions of the Federal Reserve Act.

(2) In the event notes which evidence loans made pursuant to a commodity loan program of the Commodity Credit Corporation and which

\(^2\) Under the provisions of the last paragraph of section 13 of the Federal Reserve Act, any Federal Reserve Bank may make advances for periods not exceeding ninety days to individuals, partnerships, or corporations (including banks) on their promissory notes secured by direct obligations of the United States at rates fixed for the purpose. However, the maturity of any borrowing to meet the temporary credit needs of a member bank should ordinarily be limited to fifteen days.

\(^3\) Such advances may also be made on notes secured by the pledge of Federal Farm Mortgage Corporation bonds issued under the Federal Farm Mortgage Corporation Act and Home Owners' Loan Corporation bonds issued under section 4(c) of the Home Owners' Loan Act of 1933, which are guaranteed as to principal and interest by the United States.

\(^4\) However, as stated in paragraph (2) of section 1 of this Regulation, the maturity of any borrowing to meet the temporary credit needs of a member bank should ordinarily be limited to short periods.
comply with the maturity requirements of subsection (a) of section 3 of this Regulation have been deposited in a pool of notes operated by the Commodity Credit Corporation, the certificate of interest issued by the Commodity Credit Corporation which evidences the deposit of such notes may be accepted as security for an advance made to a member bank under this subsection.

(c) Advances on other security under section 10(b) of the Federal Reserve Act.—Any Federal Reserve Bank may make advances, under authority of section 10(b) of the Federal Reserve Act, to any of its member banks upon the latter's promissory note secured to the satisfaction of such Federal Reserve Bank. The rate on advances made under the provisions of this subsection shall in no event be less than one-half of 1 per cent per annum higher than the highest rate applicable to discounts for member banks under the provisions of sections 13 and 13a of the Federal Reserve Act in effect at such Federal Reserve Bank. Such an advance must be evidenced by the promissory note of such member bank payable either (1) on a definite date not more than four months after the date of such advance, or (2) at the option of the holder on or before a definite date not more than four months after the date of such advance.

SECTION 3. DISCOUNT OF NOTES, DRAFTS AND BILLS FOR MEMBER BANKS

(a) Commercial, agricultural and industrial paper.—Any Federal Reserve Bank may discount for any of its member banks, under authority
of sections 13 and 13a of the Federal Reserve Act, any note, draft, or bill of exchange which meets the following requirements:

1. It must be a negotiable note, draft, or bill of exchange, bearing the endorsement of a member bank, which has been issued or drawn, or the proceeds of which have been used or are to be used, in producing, purchasing, carrying or marketing goods— in one or more of the steps of the process of production, manufacture, or distribution, or in meeting current operating expenses of a commercial, agricultural or industrial business, or for the purpose of carrying or trading in direct obligations of the United States (i.e., bonds, notes, Treasury bills or certificates of indebtedness of the United States);

2. It must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as land, buildings or machinery, or for any other fixed capital purpose;

3. It must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for

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6/ As used in this Regulation the word "goods" shall be construed to include goods, wares, merchandise, or agricultural products, including livestock.
transactions of a purely speculative character or issued or drawn for the purpose of carrying or trading in stocks, bonds or other investment securities except direct obligations of the United States (i.e., bonds, notes, Treasury bills or certificates of indebtedness of the United States);

4. It must have a maturity at the time of discount of not exceeding ninety days, exclusive of days of grace, except that agricultural paper as defined below in this section of this Regulation may have a maturity of not exceeding nine months, exclusive of days of grace; but this requirement is not applicable with respect to bills of exchange payable at sight or on demand of the kind described in subsection (b) of this section.

(b) Bills of exchange payable at sight or on demand.—Any Federal Reserve Bank may discount for any of its member banks, under authority of section 13 of the Federal Reserve Act, negotiable bills of exchange payable at sight or on demand which (1) bear the endorsement of a member bank, (2) grow out of the domestic shipment or the exportation of nonperishable, readily marketable staples, and (3) are secured

7/ A readily marketable staple within the meaning of this Regulation means an article of commerce, agriculture, or industry of such uses as to make it the subject of constant dealings in ready markets with such frequent quotations of price as to make (a) the price easily and definitely ascertainable and (b) the staple itself easy to realize upon by sale at any time.
by bills of lading or other shipping documents conveying or securing
title to such staples. All such bills of exchange shall be forwarded
promptly for collection, and demand for payment shall be made promptly,
unless the drawer instructs that they be held until arrival of such
staples at their destination, in which event they must be presented for
payment within a reasonable time after notice of such arrival has been
received. In no event shall any such bill be held by or for the account
of a Federal Reserve Bank for a period in excess of ninety days.

(c) Bankers' Acceptances.—Any Federal Reserve Bank may
discount for any of its member banks a banker's acceptance—\(6/\) which
bears the endorsement of a member bank and (i) which grows out of
transactions involving the importation or exportation of goods, the
shipment of goods within the United States, or the storage of readily
marketable staples,\(^2/\) as such transactions are more fully described

\(6/\) A banker's acceptance within the meaning of this Regulation is a
draft or bill of exchange, whether payable in the United States or
abroad and whether payable in dollars or some other money, accepted by
a bank or trust company or a firm, person, company, or corporation en-
gaged generally in the business of granting bankers' acceptance credits.

\(^2/\) In the case of an acceptance growing out of the storage of readily
marketable staples, the bill must be secured at the time of acceptance
by a warehouse, terminal, or other similar receipt, conveying security
title to such staples, issued by a party independent of the customer or
issued by a grain elevator or warehouse company duly bonded and licensed
and regularly inspected by State or Federal authorities with whom all
receipts for such staples and all transfers thereof are registered and
without whose consent no staples may be withdrawn; and the acceptor
must remain secured throughout the life of the acceptance. If the
goods are withdrawn from storage before maturity of the acceptance or
retirement of the credit, a trust receipt or other similar document
covering the goods may be substituted in lieu of the original docu-
ment, provided that such substitution is conditioned upon a reasonably
prompt liquidation of the credit; and, to this end, it should be re-
quired, when the original document is released, either that the proceeds
of the goods will be applied within a specified time toward a liquida-
tion of the acceptance credit or that a new document, similar to the
original one, will be resubstituted within a specified time.
in paragraphs (1), (2), and (3), respectively, of section 1(a) of the Board's Regulation C, or (ii) which has been drawn by a bank or banker in a foreign country or dependency or insular possession of the United States for the purpose of furnishing dollar exchange as provided in section 2 of Regulation C; provided, that any such acceptance shall have a maturity at the time of discount of not more than 90 days' sight, exclusive of days of grace, except that an acceptance drawn for agricultural purposes and secured at the time of acceptance by warehouse receipts or other such documents conveying or securing title covering readily marketable staples may be discounted with a maturity at the time of discount of not more than six months' sight, exclusive of days of grace; and provided further, that acceptances for any one customer in

10/ The bill itself should be drawn so as to evidence the character of the underlying transaction, but if it is not so drawn evidence of eligibility may consist of a stamp or certificate affixed by the acceptor in form satisfactory to the Federal Reserve Bank.

11/ No acceptance discounted by a Federal Reserve Bank should have a maturity in excess of the usual or customary period of credit required to finance the underlying transaction or of the period reasonably necessary to finance such transaction; and no acceptance growing out of the storage of readily marketable staples should have a maturity in excess of the time ordinarily necessary to effect a reasonably prompt sale, shipment, or distribution into the process of manufacture or consumption.
excess of 10 per cent of the capital and surplus of the accepting bank must remain actually secured throughout the life of the acceptance. 12/

(d) Construction loans.—In addition to paper of the kinds specified above, any Federal Reserve Bank may discount for any of its member banks, under authority of section 24 of the Federal Reserve Act, a negotiable note which (1) represents a loan made to finance the construction of a residential or a farm building whether or not secured by lien upon real estate, (2) is endorsed by such member bank, (3) is accompanied by a valid and binding agreement, entered into by a person 13/ acceptable to the discounting Federal Reserve Bank, requiring such person to advance the full amount of the loan upon the completion of the construction of such residential or farm building, and (4) matures not more than six months from the date such loan was made and not more than ninety days from the date of such discount by such Federal Reserve Bank, exclusive of days of grace.

12/ In the case of the acceptances of member banks this security must consist of shipping documents, warehouse receipts, or other such documents, or some other actual security growing out of the same transaction as the acceptance, such as documentary drafts, trade acceptances, terminal receipts, or trust receipts which have been issued under such circumstances, and which cover goods of such a character, as to insure at all times a continuance of an effective and lawful lien in favor of the accepting bank, other trust receipts not being considered such actual security if they permit the customer to have access to or control over the goods.

13/ Such person may be the member bank offering the note for discount or any other individual, partnership, association or corporation.
(e) **Agricultural paper.**—Agricultural paper, within the meaning of this Regulation, is a negotiable note, draft, or bill of exchange issued or drawn, or the proceeds of which have been or are to be used, for agricultural purposes, including the production of agricultural products, the marketing of agricultural products by the growers thereof, or the carrying of agricultural products by the growers thereof pending orderly marketing, and the breeding, raising, fattening, or marketing of livestock.

(f) **Paper of cooperative marketing associations.**—Notes, drafts, bills of exchange, or acceptances issued or drawn by cooperative marketing associations composed of producers of agricultural products are deemed to have been issued or drawn for an agricultural purpose within the meaning of the foregoing definition of "agricultural paper", if the proceeds thereof have been or are to be used by such association in making advances to any members thereof for an agricultural purpose, in making payments to any members thereof on account of agricultural products delivered by such members to the association, or to meet expenditures incurred or to be incurred by the association in connection with the grading, processing, packing, preparation for market, or marketing of any agricultural product handled by such association for any of its members. In addition, any other paper of such associations which complies with the applicable requirements of this Regulation may be discounted. Paper of cooperative marketing associations the proceeds of which have been or are to be used (1) to defray the expenses of organizing such
associations, or (2) for the acquisition of warehouses, for the purchase or improvement of real estate, or for any other permanent or fixed investment of any kind, is not eligible for discount, even though such warehouses or other property is to be used exclusively in connection with the ordinary operations of the association.

(g) Factors' paper.—Notes, drafts, and bills of exchange of factors issued as such for the purpose of making advances exclusively to producers of staple agricultural products in their raw state are eligible for discount with maturities not in excess of ninety days, exclusive of days of grace.

(h) Collateral securing discounted paper.—Any note, draft, or bill of exchange eligible for discount is not rendered ineligible because it is secured by the pledge of goods or collateral of any nature, including paper ineligible for discount.

(i) Determination of eligibility.—(1) A Federal Reserve Bank shall take such steps as may be necessary to satisfy itself as to the eligibility of any paper offered for discount. Compliance of paper with the provisions of paragraph (2) of subsection (a) of this section may be evidenced by a statement which adequately reflects the borrower's financial worth and evidences a reasonable excess of quick assets over current liabilities, or such compliance may be evidenced in any other manner satisfactory to the Federal Reserve Bank.

(2) The requirement of this section that a note be negotiable shall not be applicable with respect to any note evidencing a loan...
which is made pursuant to a commodity loan program of the Commodity Credit Corporation and which is subject to a commitment to purchase by the Commodity Credit Corporation or with respect to any note evidencing a loan which is in whole or in part the subject of a guarantee or commitment made pursuant to section 301 of the Defense Production Act of 1950.

(j) Limitations.--(1) The aggregate of notes, drafts, and bills upon which any person, copartnership, association, or corporation is liable as maker, acceptor, endorser, drawer, or guarantor, discounted for any member bank shall at no time exceed the amount for which such person, copartnership, association, or corporation may lawfully become liable to a national bank under the terms of section 5200 of the Revised Statutes of the United States, as amended.

(2) The law forbids a Federal Reserve Bank to discount for any State member bank notes, drafts, or bills of exchange of any one borrower who is liable for borrowed money to such State member bank in an amount greater than that which could be borrowed lawfully from such State member bank were it a national bank.

SECTION 4. GENERAL REQUIREMENTS AS TO DISCOUNTS AND ADVANCES

(a) Applications for discounts or advances.--(1) Every application by a member bank for the discount of paper or for an advance to such bank must contain a certificate of such bank, in form to be prescribed by the Federal Reserve Bank, that the paper offered for discount

/Signed/Section 5200 of the Revised Statutes of the United States is printed in the Appendix to this Regulation (page __).
or the security offered for the advance, as the case may be, has not been acquired from a nonmember bank (otherwise than in accordance with section 5 of this Regulation) or, if so acquired, that the applying member bank has received permission from the Board of Governors of the Federal Reserve System to discount with the Federal Reserve Bank paper acquired from nonmember banks or to obtain advances from the Federal Reserve Bank on security so acquired.

(2) Every such application shall also contain a notation by the member bank as to whether it has on file a statement which adequately reflects the financial worth of a party primarily liable on the paper offered as security for an advance or for discount or of the person from whom the member bank acquired such paper if such person is legally liable thereon.

(3) Every application of a State member bank for the discount of paper must contain a certificate or guaranty to the effect that the borrower is not liable and will not be permitted to become liable to such bank for borrowed money during the time his paper is under discount with the Federal Reserve Bank in an amount greater than that which could be borrowed lawfully from such State bank were it a national bank.

(b) Financial statements.—In order to determine whether paper offered for discount or security offered for an advance is eligible and acceptable, any Federal Reserve Bank may require that there be filed with it statements, or certified copies thereof, which adequately reflect
the financial worth (1) of one or more parties to any note, draft, or bill of exchange offered for discount or to any obligation offered as security for an advance and (2) of any corporations or firms affiliated with or subsidiary to such party or parties. A Federal Reserve Bank may in any case require such other information as it deems necessary.

(c) Other information.—Each Federal Reserve Bank is required by law to keep itself informed of the general character and amount of the loans and investments of its member banks with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying of or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions; and, in determining whether to grant or refuse discounts or advances, the Federal Reserve Bank is required to give consideration to such information. Each Federal Reserve Bank may require such information from its member banks as it may deem necessary in order to determine whether such undue use of bank credit is being made. It may also require such additional information as may be deemed desirable in order to determine whether the granting of any requested credit accommodation would be consistent with the principles set forth in section 1 of this Regulation.

(d) Additional or marginal collateral.—In connection with any discount or advance under this Regulation, a Federal Reserve Bank may require such additional or marginal collateral as it may deem advisable or necessary for its protection; and the requirements of this
Regulation with respect to collateral shall not be applicable to such additional or marginal collateral. In any case in which additional or marginal collateral is required, it is expected that the Federal Reserve Bank in determining the amount will give due regard to the public welfare and the general effects that its action may have on the position of the member bank, on its depositors, and on the community; and in general a Federal Reserve Bank should limit the amount of collateral it requires to the minimum consistent with safety.

SECTION 5. PAPER ACQUIRED FROM NONMEMBER BANKS

(a) Prohibition upon acceptance of nonmember bank paper.—Except with the permission of the Board of Governors of the Federal Reserve System, no Federal Reserve Bank shall discount or accept as security for an advance any assets acquired by a member bank from, or bearing the signature or endorsement of, a nonmember bank, except assets otherwise eligible which were purchased by the offering bank on the open market or otherwise acquired in good faith and not for the purpose of obtaining credit for a nonmember bank.

(b) Applications for permission.—An application for permission to discount paper acquired from nonmember banks or to use as security for advances assets acquired from nonmember banks shall be made by the member bank which desires to offer such paper for discount or such assets as security and shall state fully the facts which give rise to such application and the reasons why the applying member bank desires such permission. Such application shall be addressed to the Board of Governors.
of the Federal Reserve System but shall be submitted by the member bank to the Federal Reserve Bank of the district, which will forward it promptly to the Board of Governors of the Federal Reserve System with its recommendation.

(c) Paper acquired from Federal Intermediate Credit banks.—The Board of Governors of the Federal Reserve System hereby grants permission to Federal Reserve Banks to discount for member banks paper bearing the signature or endorsement of, or acquired from, Federal Intermediate Credit banks or to make advances to member banks upon the security of paper or assets bearing such a signature or endorsement or so acquired, if otherwise eligible under the law and this Regulation.

SECTION 6. ADVANCES TO NONMEMBER BANKS

Any Federal Reserve Bank may make advances to any nonmember bank on the promissory note of such bank secured by direct obligations of the United States, subject to the same requirements as those applicable under this Regulation to advances to member banks, but only in unusual and exigent circumstances and where the applicant submits information adequately evidencing its inability to obtain the necessary credit on reasonable terms from correspondent or other banks or from other usual sources of credit.

SECTION 7. DISCOUNTS FOR FEDERAL INTERMEDIATE CREDIT BANKS

(a) Kinds and maturity of paper.—Any Federal Reserve Bank, under authority of section 13a of the Federal Reserve Act, may, with

Such advances are authorized by the last paragraph of section 13 of the Federal Reserve Act (Appendix, p. ___).
the permission of the Board of Governors, discount for any Federal Intermediate Credit bank (1) agricultural paper as defined in section 1 of this Regulation, or (2) notes payable to such Federal Intermediate Credit bank covering loans or advances made by it pursuant to the provisions of section 202(a) of Title II of the Federal Farm Loan Act, which are secured by notes, drafts, or bills of exchange eligible for discount by Federal Reserve Banks. Any paper discounted for a Federal Intermediate Credit bank must bear the endorsement of such bank and must have a maturity at the time of discount of not more than nine months, exclusive of days of grace.

(b) Limitations. — No Federal Reserve Bank shall discount for any Federal Intermediate Credit bank any paper which bears the endorsement of any nonmember State bank or trust company which is eligible for membership in the Federal Reserve System under the terms of section 9 of the Federal Reserve Act. In acting upon applications for the discount of paper for Federal Intermediate Credit banks, each Federal Reserve Bank shall give preference to the demands of its own member banks and shall have due regard to the probable future needs of its own member banks.

APPENDIX

Statutory Provisions

[Omitted from this draft]
APPENDIX D-2

Textual Changes Which Would Be Made in Regulation A by Proposed Revision

[Old material stricken through; new material in all capitals]

REGULATION A

DISCOUNTS-FOR-AND ADVANCES TO AND DISCOUNTS FOR MEMBER BANKS

BY FEDERAL RESERVE BANKS

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GENERAL-PRINCIPLES

The guiding principle underlying the discount policy of the Federal Reserve Banks is, in the advancement of the public interest. Accordingly, the effect that the granting or withholding of credit accommodation by a Federal Reserve Bank may have on a member bank, on its depositors, and on the community is of primary importance.

In extending accommodation to any member bank, the Federal Reserve Banks are required to have due regard to the demands of other member banks, as well as to the maintenance of sound credit conditions and the accommodation of commerce, industry, and agriculture; and to consider not only the nature of the paper offered, but also the general character and amount of the loans and investments of the member bank, and whether the bank has been extending an undue amount of credit for speculative purposes in securities, real estate, or commodities, or in any other way has conducted its operations in a manner inconsistent with the maintenance of sound credit conditions.
REGULATION A

Revised effective ________, ________

DISCOUNTS FOR AND ADVANCES TO MEMBER BANKS BY
FEDERAL RESERVE BANKS

INTRODUCTION

This Regulation is based upon and issued pursuant to various provisions of the Federal Reserve Act, the most important of which, together with related provisions of law, are published in the Appendix hereto. The Regulation is applicable to the following forms of borrowing from a Federal Reserve Bank: (1) advances to member banks on their own notes secured (a) by direct obligations of the United States, by paper eligible for discount or purchase by Federal Reserve Banks, or by obligations of the United States or certain corporations owned by the United States, or (b) by other security which is satisfactory to the Federal Reserve Bank; (2) discounts for member banks of commercial, agricultural and industrial paper and bankers' acceptances; (3) advances to non-member banks on their own notes secured by direct obligations of the United States; and (4) discounts for Federal Intermediate Credit Banks.

SECTION 1. GENERAL PRINCIPLES

The basic objective underlying Federal Reserve credit policy is the advancement of the public interest by contributing to the greatest extent possible to economic stability and growth. The Federal Reserve does this largely by influencing the supply, availability, and cost of reserve funds to the banking system. The Federal Reserve may take the initiative
IN PROVIDING OR ABSORBING RESERVE FUNDS IN ACCORDANCE WITH THE NEEDS OF THE BANKING SYSTEM AS A WHOLE; THIS IS DONE THROUGH OPEN MARKET OPERATIONS AND AT TIMES THROUGH CHANGES IN RESERVE REQUIREMENTS. ON THE OTHER HAND, AN INDIVIDUAL MEMBER BANK MAY TAKE THE INITIATIVE IN OBTAINING RESERVE FUNDS BY BORROWING AT THE FEDERAL RESERVE BANKS, AT DISCOUNT RATES WHICH ARE RAISED AND LOWERED BY THE FEDERAL RESERVE FROM TIME TO TIME IN ACCORDANCE WITH THE CREDIT AND ECONOMIC SITUATION. THIS BORROWING FACILITY IS DESIGNED PRIMARILY TO PERMIT AN INDIVIDUAL MEMBER BANK TO MEET ITS TEMPORARY OR EMERGENCY NEEDS FOR RESERVE FUNDS. THE MEMBER BANK IS THEREBY ENABLED, PENDING OTHER ADJUSTMENTS IN ITS RESERVE POSITION, TO CONTINUE TO ACCOMMODATE THE LEGITIMATE CREDIT NEEDS OF COMMERCE, INDUSTRY, AND AGRICULTURE. HOWEVER, BORROWINGS BY INDIVIDUAL BANKS ADD TO THE SUPPLY OF RESERVES OF THE BANKING SYSTEM AS A WHOLE, AND THEREFORE THE MANNER AND EXTENT OF THE USE OF THE BORROWING FACILITY HAVE AN IMPORTANT BEARING UPON THE EFFECTIVENESS OF SYSTEM CREDIT POLICY.

ACCORDINGLY, IN CONSIDERATING APPLICATIONS FOR CREDIT, A FEDERAL RESERVE BANK MUST HAVE REGARD NOT ONLY TO STATUTORY AND REGULATORY REQUIREMENTS WITH RESPECT TO THE ELIGIBILITY OF THE PAPER OFFERED FOR REDISCOUNT OR AS COLLATERAL FOR ADVANCES, BUT ALSO TO CERTAIN GENERAL GUIDING PRINCIPLES, PARTICULARLY THOSE SET FORTH BELOW, WHICH HAVE BEEN ESTABLISHED BY CONGRESS IN THE LAW ITSELF OR BY THE BOARD OF GOVERNORS PURSUANT TO ITS AUTHORITY TO DEFINE THE CONDITIONS UNDER WHICH SUCH CREDIT ACCOMMODATIONS MAY BE EXTENDED. THESE PRINCIPLES TAKE ACCOUNT OF THE OBLIGATION OF THE FEDERAL RESERVE BANKS, AS STATED IN THE LAW, 1 TO GIVE DUE REGARD TO THE CLAIMS AND DEMANDS OF OTHER MEMBER

1/ SEE PARAGRAPH 8 OF SECTION 4 OF THE FEDERAL RESERVE ACT SET FORTH AT P. ____ OF THE APPENDIX TO THIS REGULATION.
Banks, the maintenance of sound credit conditions, and the accommodation of commerce, industry, and agriculture. Access to the credit facilities of the Federal Reserve Banks is a privilege of membership in the Federal Reserve System which must be considered in the light of these principles.

(1) Due regard must be given to the effect of any extension of credit upon the maintenance of sound credit conditions, both as to individual institutions and as to the economy generally. Accordingly, consideration should be given to the effect that the granting or withholding of credit accommodations may have upon the applicant member bank, its depositors, and the community and its credit needs, and whether the member bank is conducting its operations in a manner consistent with sound credit conditions.

(2) Federal Reserve credit should normally be extended for short periods to meet temporary credit needs of member banks. (For example, extension of Federal Reserve credit is appropriate in order to enable a member bank to adjust its asset position because of such developments as a temporary loss of deposits or to assist a member bank in meeting requirements for seasonal credit which cannot reasonably be anticipated and met by use of the member bank’s own resources.)

(3) In order to enable member banks to meet unusual and exigent situations, Federal Reserve credit should be extended for as long a period as may be deemed necessary — whether such situations result
FROM A NATIONAL ECONOMIC EMERGENCY, OR FROM EXIGENT REGIONAL OR LOCAL CONDITIONS, OR, IN CERTAIN SITUATIONS, FROM AN EMERGENCY INVOLVING ONLY THE PARTICULAR MEMBER BANK.

(4) WHILE UNUSUAL AND EXIGENT CIRCUMSTANCES OR SPECIAL LOCAL ECONOMIC NEEDS MAY JUSTIFY CONTINUOUS BORROWING BY A MEMBER BANK OVER A CONSIDERABLE PERIOD OF TIME, UNDER ORDINARY CONDITIONS CONTINUOUS USE OF FEDERAL RESERVE CREDIT BY A MEMBER BANK SO AS IN EFFECT TO INCREASE ITS RESOURCES, WHETHER BY LONG-TERM BORROWING OR BY FREQUENT SHORT-TERM BORROWINGS, WOULD NOT BE AN APPROPRIATE USE OF FEDERAL RESERVE CREDIT.

(5) IN DETERMINING WHETHER TO GRANT OR REFUSE CREDIT TO ANY MEMBER BANK, THE FEDERAL RESERVE BANKS ARE REQUIRED BY THE LAW TO CONSIDER THE GENERAL CHARACTER AND AMOUNT OF THE LOANS AND INVESTMENTS OF THE MEMBER BANK AND WHETHER THE BANK IS EXTENDING AN UNDUE AMOUNT OF CREDIT FOR SPECULATIVE PURPOSES IN SECURITIES, REAL ESTATE, OR COMMODITIES.

(6) FEDERAL RESERVE CREDIT SHOULD NOT BE EXTENDED WHERE IT APPEARS THAT THE MEMBER BANK'S PRINCIPAL PURPOSE IS TO PROFIT FROM RATE DIFFERENTIALS OR TO OBTAIN A TAX ADVANTAGE.

THE BOARD OF DIRECTORS OF EACH FEDERAL RESERVE BANK
IS REQUIRED BY LAW TO ADMINISTER THE AFFAIRS OF SUCH BANK
FAIRLY AND IMPARTIALLY AND WITHOUT DISCRIMINATION IN FAVOR
OF OR AGAINST ANY MEMBER BANK OR BANKS. ACCORDINGLY, IN
PASSING UPON A MEMBER BANK'S REQUEST FOR CREDIT, DUE REGARD
MUST BE GIVEN TO THE CLAIMS AND DEMANDS OF OTHER MEMBER BANKS.

SUBJECT TO CONSIDERATION OF THE PRINCIPLES ABOVE STATED AND
TO OTHER PROVISIONS OF THIS REGULATION, CREDIT ACCOMMODATIONS MAY BE
EXTENDED PURSUANT TO ANY OF THE VARIOUS PROVISIONS OF THE LAW AUTHORIZING
EXTENSIONS OF SUCH CREDIT. IN PASSING UPON REQUESTS FOR CREDIT
ACCOMMODATION, THE DIRECTORS AND OFFICERS OF THE FEDERAL RESERVE BANK
SHOULD GIVE CONSIDERATION TO ALL OF THE PRINCIPLES STATED ABOVE,
TOGETHER WITH ANY OTHER FACTORS WHICH MAY BE PERTINENT.

SECTION 2. ADVANCES TO MEMBER BANKS

(a) Advances on Government obligations.—Any Federal Reserve
Bank may make advances, under authority of section 13 of the Federal
Reserve Act, to any of its member banks for periods not exceeding

FIFTEEN days on the promissory note of such member bank

AUTHORIZES-ADVANCES-TO-MEMBER-BANKS-FOR-PERIODS-NOT-EXCEEDING-FIFTEEN
AUTHORIZES-ANY-FEDERAL-RESERVE-BANK-TO-MAKE-ADVANCES-FOR-PERIODS-NOT
EXCEEDING-NINETY-DAYS-TO-ANY-INDIVIDUAL-PARTNERSHIP-OR-CORPORATION
RESERVE BANK MAY MAKE ADVANCES FOR PERIODS NOT EXCEEDING NINETY DAYS TO
INDIVIDUALS, PARTNERSHIPS, OR CORPORATIONS (INCLUDING BANKS) ON THEIR
PROMISSORY NOTES SECURED BY DIRECT OBLIGATIONS OF THE UNITED STATES AT
RATES FIXED FOR THE PURPOSE. HOWEVER, THE MATURITY OF ANY BORROWING TO
MEET THE TEMPORARY CREDIT NEEDS OF A MEMBER BANK SHOULD ORDINARILY BE
LIMITED TO FIFTEEN DAYS.
secured (1) by direct-obligations the pledge of bonds, notes, certificates of indebtedness, or treasury bills of the United States, or and-for periods not exceeding fifteen-days-on-the-promissory-note-of-such-member bank-secured (1) (2) by the deposit-er pledge of debentures or other such obligations of Federal Intermediate Credit banks having maturities of not exceeding six months from the date of the advance—er-(2)—by the-deposit-er-pledge-of-federal-farm-mortgage-corporation-bonds-issued under-the-Federal-Farm-Mortgage-Corporation-Act-and-guaranteed-both-as to-principal-and-interest-by-the-United-States; er-(3)—by-the-deposit er-pledge-of-home-owners'-loan-corporation-bonds-issued-under-the provisions-of-subsection-(c)-of-section-4-of-the-Home-Owners'-Loan-Act of-1933, as-amended, and-guaranteed-both-as-to-principal-and-interest by-the-United-States.

(b) Advances on eligible paper.—(1) Any Federal Reserve Bank may make advances, under authority of section 13 of the Federal Reserve Act, to any of its member banks for periods not exceeding ninety days on the promissory note of such member bank secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for discount by Federal Reserve Banks under the provisions of this Regulation or for

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3/ Such advances may also be made on notes secured by the pledge of Federal Farm Mortgage Corporation bonds issued under the Federal Farm Mortgage Corporation Act and Home Owners' Loan Corporation bonds issued under section 4(c) of the Home Owners' Loan Act of 1933, which are guaranteed as to principal and interest by the United States.

3/ However, as stated in paragraph (2) of section 1 of this Regulation, the maturity of any borrowing to meet the temporary credit needs of a member bank should ordinarily be limited to short periods.
purchase by such banks under the provisions of Regulation-B THE
FEDERAL RESERVE ACT.

(2) In the event notes which evidence loans made pursuant
to a commodity loan program of the Commodity Credit Corporation and
which comply with the maturity requirements of subsection (a) of
section 4 of this Regulation have been deposited in a pool of notes
operated by the Commodity Credit Corporation, the certificate of in-
terest issued by the Commodity Credit Corporation which evidences the
deposit of such notes may be accepted as security for an advance made
to a member bank under this subsection.

(c) Advances on other security under section 10(b) of the
Federal Reserve Act.—Subject to the provisions of subsection (d) of
this section, any Federal Reserve Bank may make advances, under
authority of section 10(b) of the Federal Reserve Act, to any of its
member banks upon the latter's promissory note secured to the satis-
faction of such Federal Reserve Bank. The rate on advances made under
the provisions of this subsection shall in no event be less than one-half
of 1 per cent per annum higher than the highest rate applicable to dis-
counts for member banks under the provisions of sections 13 and 13a of
the Federal Reserve Act in effect at such Federal Reserve Bank. Such
an advance must be evidenced by the promissory note of such member bank
payable either (1) on a definite date not more than four months after
the date of such advance, or (2) at the option of the holder on or before
a definite date not more than four months after the date of such advance.

(d) Kinds of collateral which may be used as security for
advances under section 10(b) of the Federal Reserve Act.—A Federal
Reserve Bank may accept as security for an advance made under the
provisions of subsection (e) of this section—assets of any of the
classes enumerated below which are satisfactory to the Federal Reserve
Bank or paper secured by assets of such classes:

1. Assets which may be used as collateral security for
advances under subsection (a) of this section—entitled
"Advances on eligible paper" or subsection (b) of this
section—entitled "Advances on Government obligations";

2. Paper which would be eligible for discount or for
purchase by Federal Reserve Banks except by reason of the
fact that the period of its maturity is greater than that
permitted for paper eligible for discount or purchase;

3. Investment securities as defined by the Comptroller
of the Currency pursuant to section 5136 of the Revised
Statutes of the United States;

4. Obligations evidencing loans upon the security of
stock which are made in conformity with the provisions of
Regulation U;

5. Obligations insured under the provisions of Title I
or Title II of the National Housing Act;

6. Debentures, bonds, or other such obligations issued
by Federal Home Loan Banks or issued under authority of the
Federal Farm Loan Act, without regard to the maturity of
any such obligations;

7. Bills, notes, revenue bonds, and warrants which
constitute general obligations of any State or of any
political subdivision thereof.
(9) Obligations which are issued or drawn for the purpose of financing, refinancing, or carrying real estate and which comply substantially with the standards set forth in the recommendations relating to real estate loans in the Appendix to this regulation.

(10) Obligations which are issued or drawn for the purpose of financing or refinancing the sale of goods upon an installment basis and which comply substantially with the standards set forth in the recommendations relating to loans upon an installment basis in the Appendix to this regulation, and obligations of businesses principally engaged in extending credit on such basis and in substantial accordance with such standards.

In addition, when in the judgment of the Federal Reserve Bank circumstances make it advisable to do so, the Federal Reserve Bank may accept as security for an advance under subsection (c) of this section any assets other than those set forth above which are satisfactory to the Federal Reserve Bank.

SECTION 43. DISCOUNT OF NOTES, DRAFTS AND BILLS FOR MEMBER BANKS

(a) Commercial, agricultural and industrial paper.—Any Federal Reserve Bank may discount for any of its member banks, under authority

Even though paper is not eligible for discount by a Federal Reserve Bank for a member bank under the provisions of this Regulation, it may be used as security for an advance by a Federal Reserve Bank to a member bank under the terms and conditions of subsection (c) and subsection (d) of section 2 of this Regulation if it constitutes security satisfactory to the Federal Reserve Bank. In addition to the classes of paper mentioned in section 43 of this Regulation a Federal Reserve Bank may discount bankers' acceptances in accordance with the provisions of section 68 of this Regulation.
of sections 13 and 13a of the Federal Reserve Act, any note, draft, or bill of exchange which meets the following requirements:

(1) It must be a negotiable note, draft, or bill of exchange, bearing the endorsement of a member bank, which has been issued or drawn, or the proceeds of which have been used or are to be used, in producing, purchasing, carrying or marketing goods in one or more of the steps of the process of production, manufacture, or distribution, or in meeting current operating expenses of a commercial, agricultural or industrial business, or for the purpose of carrying or trading in direct obligations of the United States (i.e., bonds, notes, Treasury bills or certificates of indebtedness of the United States);

(2) It must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as land, buildings or machinery, or for any other fixed capital purpose;

(3) It must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for transactions of a purely speculative character or issued or drawn for the purpose of carrying or trading in stocks, bonds or other investment securities except direct obligations of the United States (i.e., bonds, notes, Treasury bills or certificates of indebtedness of the United States);

\textsuperscript{[2/6]} As used in this Regulation the word "goods" shall be construed to include goods, wares, merchandise, or agricultural products, including livestock.
(4) It must have a maturity at the time of discount of not exceeding ninety days, exclusive of days of grace, except that agricultural paper as defined below in this section of this Regulation may have a maturity of not exceeding nine months, exclusive of days of grace; but this requirement is not applicable with respect to bills of exchange payable at sight or on demand of the kind described in subsection (b) of this section.

(b) Bills of exchange payable at sight or on demand.--Any Federal Reserve Bank may discount for any of its member banks, under authority of section 13 of the Federal Reserve Act, negotiable bills of exchange payable at sight or on demand which (1) bear the endorsement of a member bank, (2) grow out of the domestic shipment or the exportation of nonperishable, readily marketable staples, and (3) are secured by bills of lading or other shipping documents conveying or securing title to such staples. All such bills of exchange shall be forwarded promptly for collection, and demand for payment shall be made promptly, unless the drawer instructs that they be held until arrival of such staples at their destination, in which event they must be presented for payment within a reasonable time after notice of such arrival has been received. In no event shall any such bill be held by or for the account of a Federal Reserve Bank for a period in excess of ninety days.

\[1/\text{A readily marketable staple within the meaning of this Regulation means an article of commerce, agriculture, or industry of such uses as to make it the subject of constant dealings in ready markets with such frequent quotations of price as to make (a) the price easily and definitely ascertainable and (b) the staple itself easy to realize upon by sale at any time.}\]
*(c) BANKERS’ ACCEPTANCES.--ANY FEDERAL RESERVE BANK MAY
DISCOUNT FOR ANY OF ITS MEMBER BANKS A BANKER’S ACCEPTANCE--WHICH
BEARS THE ENDORSEMENT OF A MEMBER BANK AND (1) WHICH GROWS OUT OF
TRANSACTIONS INVOLVING THE IMPORTATION OR EXPORTATION OF GOODS, THE
SHIPMENT OF GOODS WITHIN THE UNITED STATES, OR THE STORAGE OF READILY
MARKETABLE STAPLES, AS SUCH TRANSACTIONS ARE MORE FULLY DESCRIBED
IN PARAGRAPHS (1), (2), AND (3), RESPECTIVELY, OF SECTION 1(a) OF THE

8/ A BANKER’S ACCEPTANCE WITHIN THE MEANING OF THIS REGULATION IS A DRAFT
OR BILL OF EXCHANGE, WHETHER PAYABLE IN THE UNITED STATES OR ABROAD AND
WHETHER PAYABLE IN DOLLARS OR SOME OTHER MONEY, ACCEPTED BY A BANK OR
TRUST COMPANY OR A FIRM, PERSON, COMPANY, OR CORPORATION ENGAGED GENERALLY
IN THE BUSINESS OF GRANTING BANKERS’ ACCEPTANCE CREDITS.

9/ IN THE CASE OF AN ACCEPTANCE GROWING OUT OF THE STORAGE OF READILY
MARKETABLE STAPLES, THE BILL MUST BE SECURED AT THE TIME OF ACCEPTANCE
BY A WAREHOUSE, TERMINAL, OR OTHER SIMILAR RECEIPT, CONVEYING SECURITY
TITLE TO SUCH STAPLES, ISSUED BY A PARTY INDEPENDENT OF THE CUSTOMER OR
ISSUED BY A GRAIN ELEVATOR OR WAREHOUSE COMPANY DULL BONDED AND LICENSED
AND REGULARLY INSPECTED BY STATE OR FEDERAL AUTHORITIES WITH WHOM ALL
RECEIPTS FOR SUCH STAPLES AND ALL TRANSFERS THEREOF ARE REGISTERED AND
WITHOUT WHOSE CONSENT NO STAPLES MAY BE WITHDRAWN; AND THE ACCEPTOR MUST
REMAIN SECURED THROUGHOUT THE LIFE OF THE ACCEPTANCE. IF THE GOODS ARE
WITHDRAWN FROM STORAGE BEFORE MATURITY OF THE ACCEPTANCE OR RETIREMENT
OF THE CREDIT, A TRUST RECEIPT OR OTHER SIMILAR DOCUMENT COVERING THE
GOODS MAY BE SUBSTITUTED IN LIEU OF THE ORIGINAL DOCUMENT, PROVIDED
 THAT SUCH SUBSTITUTION IS CONDITIONED UPON A REASONABLY PROMPT LIQUIDA­
TION OF THE CREDIT; AND, TO THIS END, IT SHOULD BE REQUIRED, WHEN THE
ORIGINAL DOCUMENT IS RELEASED, EITHER THAT THE PROCEEDS OF THE GOODS
WILL BE APPLIED WITHIN A SPECIFIED TIME TOWARD A LIQUIDATION OF THE
ACCEPTANCE CREDIT OR THAT A NEW DOCUMENT, SIMILAR TO THE ORIGINAL ONE,
WILL BE RESUBSTITUTED WITHIN A SPECIFIED TIME.

*NOTE.—The substance of this subsection is not new; it represents
merely a restatement in somewhat condensed form of the pro­
visions previously contained in section 6 of Regulation A
relating to bankers’ acceptances.
BOARD'S REGULATION C, or (ii) which has been drawn by a bank or banker in a foreign country or dependency or insular possession of the United States for the purpose of furnishing dollar exchange as provided in section 2 of regulation C; provided, that any such acceptance shall have a maturity at the time of discount of not more than 90 days' sight, exclusive of days of grace, except that an acceptance drawn for agricultural purposes and secured at the time of acceptance by warehouse receipts or other such documents conveying or securing title covering readily marketable staples may be discounted with a maturity at the time of discount of not more than six months' sight, exclusive of days of grace; and provided further, that acceptances for any one customer in excess of 10 per cent of the capital and surplus of the accepting bank must remain actually secured throughout the life of the acceptance.

10/ The bill itself should be drawn so as to evidence the character of the underlying transaction, but if it is not so drawn evidence of eligibility may consist of a stamp or certificate affixed by the acceptor in form satisfactory to the Federal Reserve Bank.

11/ No acceptance discounted by a Federal Reserve Bank should have a maturity in excess of the usual or customary period of credit required to finance the underlying transaction or of the period reasonably necessary to finance such transaction; and no acceptance growing out of the storage of readily marketable staples should have a maturity in excess of the time ordinarily necessary to effect a reasonably prompt sale, shipment, or distribution into the process of manufacture or consumption.

12/ In the case of the acceptances of member banks this security must consist of shipping documents, warehouse receipts, or other such documents, or some other actual security growing out of the same transaction as the acceptance, such as documentary drafts, trade acceptances, terminal receipts, or trust receipts which have been issued under such circumstances, and which cover goods of such a character, as to insure at all times a continuance of an effective and lawful lien in favor of the accepting bank, other trust receipts not being considered such actual security if they permit the customer to have access to or control over the goods.
(e) (d) Construction loans.—In addition to paper of the kinds specified above, any Federal Reserve Bank may discount for any of its member banks, under authority of section 24 of the Federal Reserve Act, a negotiable note which (1) represents a loan made to finance the construction of a residential or a farm building whether or not secured by lien upon real estate, (2) is endorsed by such member bank, (3) is accompanied by a valid and binding agreement, entered into by a person acceptable to the discounting Federal Reserve Bank, requiring such person to advance the full amount of the loan upon the completion of the construction of such residential or farm building, and (4) matures not more than six months from the date such loan was made and not more than ninety days from the date of such discount by such Federal Reserve Bank, exclusive of days of grace.

(f) (e) Agricultural paper.—Agricultural paper, within the meaning of this Regulation, is a negotiable note, draft, or bill of exchange issued or drawn, or the proceeds of which have been or are to be used, for agricultural purposes, including the production of agricultural products, the marketing of agricultural products by the growers thereof, or the carrying of agricultural products by the growers thereof pending orderly marketing, and the breeding, raising, fattening, or marketing of livestock.

(f) (f) Paper of cooperative marketing associations.—Notes, drafts, bills of exchange, or acceptances issued or drawn by cooperative marketing associations composed of producers of agricultural products are deemed to have been issued or drawn for an agricultural purpose within Such person may be the member bank offering the note for discount or any other individual, partnership, association or corporation.
the meaning of the foregoing definition of "agricultural paper", if the proceeds thereof have been or are to be used by such association in making advances to any members thereof for an agricultural purpose, in making payments to any members thereof on account of agricultural products delivered by such members to the association, or to meet expenditures incurred or to be incurred by the association in connection with the grading, processing, packing, preparation for market, or marketing of any agricultural product handled by such association for any of its members. In addition, any other paper of such associations which complies with the applicable requirements of this Regulation may be discounted. Paper of cooperative marketing associations the proceeds of which have been or are to be used (1) to defray the expenses of organizing such associations, or (2) for the acquisition of warehouses, for the purchase or improvement of real estate, or for any other permanent or fixed investment of any kind, is not eligible for discount, even though such warehouses or other property is to be used exclusively in connection with the ordinary operations of the association.

(g) Factors' paper.—Notes, drafts, and bills of exchange of factors issued as such for the purpose of making advances exclusively to producers of staple agricultural products in their raw state are eligible for discount with maturities not in excess of ninety days, exclusive of days of grace.

(h) Collateral securing discounted paper.—Any note, draft, or bill of exchange eligible for discount is not rendered ineligible because it is secured by the pledge of goods or collateral of any nature, including paper ineligible for discount.
Determination of eligibility.--(1) A Federal Reserve Bank shall take such steps as may be necessary to satisfy itself as to the eligibility of any paper offered for discount. Compliance of paper with the provisions of paragraph (2) of subsection (a) of this section may be evidenced by a statement which adequately reflects the borrower's financial worth and evidences a reasonable excess of quick assets over current liabilities, or such compliance may be evidenced in any other manner satisfactory to the Federal Reserve Bank.

(2) The requirement of this section that a note be negotiable shall not be applicable with respect to any note evidencing a loan which is made pursuant to a commodity loan program of the Commodity Credit Corporation and which is subject to a commitment to purchase by the Commodity Credit Corporation or with respect to any note evidencing a loan which is in whole or in part the subject of a guarantee or commitment made pursuant to section 301 of the Defense Production Act of 1950.

Limitations.--(1) The aggregate of notes, drafts, and bills upon which any person, copartnership, association, or corporation is liable as maker, acceptor, endorser, drawer, or guarantor, discounted for any member bank shall at no time exceed the amount for which such person, copartnership, association, or corporation may lawfully become liable to a national bank under the terms of section 5200 of the Revised Statutes of the United States, as amended.

Section 5200 of the Revised Statutes of the United States is printed in the Appendix to this Regulation (page 22) together with a tabular analysis of the section prepared in the Office of the Comptroller of the Currency (page 22).
(2) The law forbids a Federal Reserve Bank to discount for any State member bank notes, drafts, or bills of exchange of any one borrower who is liable for borrowed money to such State member bank in an amount greater than that which could be borrowed lawfully from such State member bank were it a national bank.

SECTION 3.1. GENERAL REQUIREMENTS AS TO DISCOUNTS AND ADVANCES

(a) Applications for discounts or advances.--(1) Every application by a member bank for the discount of paper or for an advance to such bank must contain a certificate of such bank, in form to be prescribed by the Federal Reserve Bank, that the paper offered for discount or the security offered for the advance, as the case may be, has not been acquired from a nonmember bank (otherwise than in accordance with section 5 of this Regulation) or, if so acquired, that the applying member bank has received permission from the Board of Governors of the Federal Reserve System to discount with the Federal Reserve Bank paper acquired from nonmember banks or to obtain advances from the Federal Reserve Bank on security so acquired.

(2) Every such application shall also contain a notation by the member bank as to whether it has on file a statement which adequately reflects the financial worth of a party primarily liable on the paper offered as security for an advance or for discount or of the person from whom the member bank acquired such paper if such person is legally liable thereon.

(3) Every application of a State member bank for the discount of paper must contain a certificate or guaranty to the effect that the borrower is not liable and will not be permitted to become liable to such
bank for borrowed money during the time his paper is under discount with
the Federal Reserve Bank in an amount greater than that which could be
borrowed lawfully from such State bank were it a national bank.

(b) Financial statements.—In order to determine whether paper
offered for discount or security offered for an advance is eligible and
acceptable, any Federal Reserve Bank may require that there be filed with
it statements, or certified copies thereof, which adequately reflect the
financial worth (1) of one or more parties to any note, draft, or bill
of exchange offered for discount or to any obligation offered as security
for an advance and (2) of any corporations or firms affiliated with or
subsidiary to such party or parties. A Federal Reserve Bank may in any
case require such other information as it deems necessary.

(c) Speculative-use-of-credit-by-a-member-bank—OTHER
INFORMATION.—Each Federal Reserve Bank is required by law to keep itself
informed of the general character and amount of the loans and investments
of its member banks with a view to ascertaining whether undue use is being
made of bank credit for the speculative carrying of or trading in securi-
ties, real estate, or commodities, or for any other purpose inconsistent
with the maintenance of sound credit conditions; and, in determining
whether to grant or refuse discounts or advances, the Federal Reserve Bank
is required to give consideration to such information. Each Federal
Reserve Bank may require such information from its member banks as it
may deem necessary in order to determine whether such undue use of bank
credit is being made. IT MAY ALSO REQUIRE SUCH ADDITIONAL INFORMATION
AS MAY BE DEEMED DESIRABLE IN ORDER TO DETERMINE WHETHER THE GRANTING
OF ANY REQUESTED CREDIT ACCOMMODATION WOULD BE CONSISTENT WITH THE
PRINCIPLES SET FORTH IN SECTION 1 OF THIS REGULATION.

(d) **Additional or marginal collateral.**—In connection with
any discount or advance under this Regulation, a Federal Reserve Bank
may require such additional or marginal collateral as it may deem ad-
visable or necessary for its protection; and the requirements of this
Regulation with respect to collateral shall not be applicable to such
additional or marginal collateral. In any case in which additional or
marginal collateral is required, it is expected that the Federal Reserve
Bank in determining the amount will give due regard to the public welfare
and the general effects that its action may have on the position of the
member bank, on its depositors, and on the community; and in general a
Federal Reserve Bank should limit the amount of collateral it requires
to the minimum consistent with safety. In any case where the amount
of the assets of a member bank, at their reasonable value determined
in a manner satisfactory to the Reserve Bank, required as collateral
in connection with any discount or advance under the provisions of this
Regulation exceeds at the time of the discount or advance 25 per cent
of the amount of paper discounted or 125 per cent of the amount of the
advance, as the case may be, the Federal Reserve Bank shall include an
explanation of the facts and circumstances of the case in its loan
schedule submitted to the Board of Governors of the Federal Reserve System.
(c) Credit extended on security of obligations of the United States—In any case in which the amount of an advance made by a Federal Reserve Bank in accordance with the provisions of this regulation on a member bank’s promissory note secured by direct obligations of the United States or obligations which are guaranteed both as to principal and interest by the United States is less than the face amount of such obligations, the Reserve Bank shall include an explanation of the facts and circumstances of the case in its loan schedule submitted to the Board of Governors of the Federal Reserve System.

SECTION 45. PAPER ACQUIRED FROM NONMEMBER BANKS

(a) Prohibition upon acceptance of nonmember bank paper.—Except with the permission of the Board of Governors of the Federal Reserve System, no Federal Reserve Bank shall discount or accept as security for an advance any assets acquired by a member bank from, or bearing the signature or endorsement of, a nonmember bank, except assets otherwise eligible which were purchased by the offering bank on the open market or otherwise acquired in good faith and not for the purpose of obtaining credit for a nonmember bank.

(b) Applications for permission.—An application for permission to discount paper acquired from nonmember banks or to use as security for advances assets acquired from nonmember banks shall be made by the member bank which desires to offer such paper for discount or such assets as security and shall state fully the facts which give rise to
such application and the reasons why the applying member bank desires such permission. Such application shall be addressed to the Board of Governors of the Federal Reserve System but shall be submitted by the member bank to the Federal Reserve Bank of the district, which will forward it promptly to the Board of Governors of the Federal Reserve System with its recommendation.

(c) Paper acquired from Federal Intermediate Credit banks.—The Board of Governors of the Federal Reserve System hereby grants permission to Federal Reserve Banks to discount for member banks paper bearing the signature or endorsement of, or acquired from, Federal Intermediate Credit banks or to make advances to member banks upon the security of paper or assets bearing such a signature or endorsement or so acquired, if otherwise eligible under the law and this Regulation.

SECTION 6. ADVANCES TO NONMEMBER BANKS

ANY FEDERAL RESERVE BANK MAY MAKE ADVANCES TO ANY NONMEMBER BANK ON THE PROMISSORY NOTE OF SUCH BANK SECURED BY DIRECT OBLIGATIONS OF THE UNITED STATES, SUBJECT TO THE SAME REQUIREMENTS AS THOSE APPLICABLE UNDER THIS REGULATION TO ADVANCES TO MEMBER BANKS, BUT ONLY IN UNUSUAL AND EXIGENT CIRCUMSTANCES AND WHERE THE APPLICANT SUBMITS INFORMATION ADEQUATELY EVIDENCING ITS INABILITY TO OBTAIN THE NECESSARY CREDIT ON REASONABLE TERMS FROM CORRESPONDENT OR OTHER BANKS OR FROM OTHER USUAL SOURCES OF CREDIT.

Such advances are authorized by the last paragraph of Section 13 of the Federal Reserve Act (Appendix, P. ____).
SECTION § 7. DISCOUNTS FOR FEDERAL INTERMEDIATE CREDIT BANKS

(a) Kinds and maturity of paper.--Any Federal Reserve Bank, under authority of section 13a of the Federal Reserve Act, may, with the permission of the Board of Governors, discount for any Federal Intermediate Credit bank (1) agricultural paper as defined in section 1 of this Regulation, or (2) notes payable to such Federal Intermediate Credit bank covering loans or advances made by it pursuant to the provisions of section 202(a) of Title II of the Federal Farm Loan Act, which are secured by notes, drafts, or bills of exchange eligible for discount by Federal Reserve Banks. Any paper discounted for a Federal Intermediate Credit bank must bear the endorsement of such bank and must have a maturity at the time of discount of not more than nine months, exclusive of days of grace.

(b) Limitations.--No Federal Reserve Bank shall discount for any Federal Intermediate Credit bank any paper which bears the endorsement of any nonmember State bank or trust company which is eligible for membership in the Federal Reserve System under the terms of section 9 of the Federal Reserve Act. In acting upon applications for the discount of paper for Federal Intermediate Credit banks, each Federal Reserve Bank shall give preference to the demands of its own member banks and shall have due regard to the probable future needs of its own member banks. Except with the permission of the Board of Governors of the Federal Reserve System, no Federal Reserve Bank shall discount paper for any Federal Intermediate Credit bank when its own reserves amount to less than 50 per cent of its own aggregate liabilities for deposits and Federal Reserve notes in actual circulation.
SECTION 6. BANKERS' ACCEPTANCES

(a) Definition.—A banker's acceptance within the meaning of this Regulation is a draft or bill of exchange, whether payable in the United States or abroad and whether payable in dollars or some other money, accepted by a bank or trust company, or a firm, person, company, or corporation engaged generally in the business of granting bankers' acceptance credits.

(b) Eligibility.—Any Federal Reserve Bank may discount for any of its member banks any such banker's acceptance bearing the endorsement of a member bank and having a maturity at the time of discount not greater than that prescribed by subsection (c) of this section, which has been drawn under a credit opened for the purpose of conducting or settling accounts resulting from a transaction or transactions involving any one of the following:

1. The shipment of goods between the United States and any foreign country; or between the United States and any of its dependencies or insular possessions; or between dependencies or insular possessions and foreign countries, or between foreign countries.

NOTE.—The substance of this section would be retained, though in different form, in new subsection (c) of section 3 of the revised Regulation.
(2) The shipment of goods within the United States, provided shipping documents conveying security title are attached at the time of acceptance; or

(3) The storage in the United States or in any foreign country of readily-marketable staples, provided that the bill is secured at the time of acceptance by a warehouse, terminal, or other similar receipt, conveying security title to such staples, issued by a party independent of the customer or issued by a grain elevator or warehouse company duly bonded and licensed and regularly inspected by State or Federal authorities with whom all receipts for such staples and all transfers thereof are registered and without whose consent no staples may be withdrawn; and provided further that the acceptor remains secured throughout the life of the acceptance. In the event that the goods must be withdrawn from storage prior to the maturity of the acceptance or the retirement of the credit, a trust receipt or other similar document covering the goods may be substituted in lieu of the original document, provided that such substitution is conditioned upon a reasonably prompt liquidation of the credit.

In order to insure compliance with this condition it should be required, when the original document is released, either (A) that the proceeds of the goods will be applied within a specified time toward a liquidation of

\[ A \] readily-marketable staple within the meaning of this regulation means an article of commerce, agriculture, or industry of such uses as to make it the subject of constant dealings in ready markets with such frequent quotations of price as to make (a) the price easily and definitely ascertainable and (b) the staple itself easy to realize upon by sale at any time.
the acceptance credit or (B) that a new document, similar to the original one, will be resubstituted within a specified time.

Provided, That acceptances for any one customer in excess of 10 per cent of the capital and surplus of the accepting bank must remain actually secured throughout the life of the acceptance, and in the case of the acceptances of member banks this security must consist of shipping documents, warehouse receipts, or other such documents, or some other actual security growing out of the same transaction as the acceptance, such as documentary drafts, trade acceptances, terminal receipts, or trust receipts which have been issued under such circumstances, and which cover goods of such a character, as to insure at all times a continuance of an effective and lawful lien in favor of the accepting bank; other trust receipts not being considered such actual security if they permit the customer to have access to or control over the goods.

(c) Maturities: No such acceptance is eligible for discount which has a maturity at the time of discount in excess of ninety days' sight, exclusive of days of grace, except that acceptances drawn for agricultural purposes and secured at the time of acceptance by warehouse receipts or other such documents conveying or securing title covering readily-marketable staples may be discounted with maturities at the time of discount of not more than six months' sight, exclusive of days of grace. Although a Federal Reserve Bank may legally discount an acceptance having a maturity at the time of discount net greater than
that prescribed above in this subsection, an acceptance should not have a maturity which is in excess of the usual or customary period of credit required to finance the underlying transaction or which is in excess of the period reasonably necessary to finance such transaction. Since the purpose of permitting the acceptance of drafts secured by warehouse receipts or other such documents is to permit the temporary holding of readily-marketable staples in storage pending a reasonably-prompt sale, shipment, or distribution, no such acceptance should have a maturity in excess of the time ordinarily necessary to effect a reasonably-prompt sale, shipment, or distribution into the process of manufacture or consumption.

(d) Dollar-exchange-acceptances.—A Federal Reserve Bank may also discount any bill drawn by a bank or banker in a foreign country or dependency or insular possession of the United States for the purpose of furnishing dollar-exchange as provided in Regulation C, provided that it has a maturity at the time of discount of not more than three months, exclusive of days of grace.

(e) Evidence of eligibility.—A Federal Reserve Bank must be satisfied, either by reference to the acceptance itself or otherwise, that the acceptance is eligible for discount under the terms of the law and the provisions of this Regulation. The bill itself should be drawn so as to evidence the character of the underlying transaction, but if it is not so drawn evidence of eligibility may consist of a stamp or certificate affixed by the acceptor in form satisfactory to the Federal Reserve Bank.
APPENDIX

Recommendations of the Board of Governors of the Federal Reserve System as to the Minimum Standards Which Should Be Observed by Member Banks in Making Loans upon Real Estate

While recognizing that requirements of individual banks in making loans for the purpose of financing or carrying real estate will vary according to the circumstances of particular transactions, the Board of Governors of the Federal Reserve System believes that certain minimum standards should be observed. Some of these standards are specifically required by law with respect to loans of national banks. Others are advisable as a matter of sound banking practice. The examiners for the Federal Reserve Banks should take such standards into consideration in reviewing loans of State member banks, and Federal Reserve Banks in passing upon applications of member banks for credit accommodations supported by real estate loans should give preference to the acceptance as collateral of such loans as meet these standards.

With these considerations in mind the Board recommends that member banks in making or acquiring real estate loans, other than those insured under Title II of the National Housing Act, apply the standards set forth below as minimum requirements:

(1) Obligations issued or drawn for the purpose of financing, refinancing, or carrying real estate should be secured by first lien evidenced by mortgage, trust deed, or other such instrument upon improved real estate, including improved farm, land and improved business and residential properties;
(2) The amount of the lean or leans evidenced by such obligations should not exceed 50 per cent of the appraised value of the real estate securing such lean or leans and no such lean should be for a longer term than five years, except that any such lean may be in an amount not exceeding 60 per cent of the appraised value of the real estate securing such lean and for a term not longer than ten years if the lean is secured by an amortised mortgage, deed of trust, or other such instrument under the terms of which 50 per cent or more of the principal of the lean will be amortised within a period of not more than ten years by means of substantially equal, monthly, quarterly, semiannual, or annual payments on principal with interest added or on principal and interest combined, and member-banks should take reasonable steps to satisfy themselves that the payments and other requirements of the obligations will be met in accordance with their terms;

(3) There should be on file with the member-bank with respect to such obligations the following documents or properly certified or photostat copies thereof:

(a) an appraisal of the value of the real estate which has been made within a reasonable time before the obligation was acquired by the member-bank; (i) by one or more competent and experienced appraisers
independent-of-the-member-bank-who-have-no-interest-
direct-or-indirectly-in-the-real-estate-or-(ii)-if
the-member-bank-maintains-a-separate-real-estate-department-by-one-or-more-officers-or-employees-who-are
regularly-assigned-to-such-department-who-specialise
in-real-estate-appraisals-and-who-have-no-interest-
direct-or-indirectly-in-the-real-estate-or-(iii)-by-a
committee-appointed-by-the-board-of-directors-and
consisting-of-not-less-than-two-members-who-are-qualified
for-the-purpose-and-have-no-interest-direct-or-indirectly
in-the-real-estate-and-which-appraisal-contains,-in-addi-
tion-to-such-other-data-as-may-be-required-by-the-member
bank-statement-as-to-the-purpose-for-which-the-real
estate-is-used-or-is-proposed-to-be-used-and-the-nature-and
amount-of-the-income-received-therefrom;

(b)-an-adequate-description-of-the-real-estate,
including-the-improvements;

(c)-evidence-of-the-title-to-the-real-estate-in-the
form-of-a-certificate-of-a-title-company,-a-title-insurance
policy,-an-opinion-of-a-competent-attorney,-or-other-form
satisfactory-to-the-member-bank;

(d)-satisfactory-evidence-that-no-taxes-or-assessments
thereon-are-delinquent-and-that-satisfactory-insurance-is
carried-and

(e)-such-other-information-and-documents-as-the-circum-
stances-of-the-case-may-render-advisable
Recommendations of the Board of Governors of the Federal Reserve System as to the Minimum Standards for Installment-Paper Used as Collateral Security for Advances to Member Banks

While recognizing that requirements of individual banks in making loans for the purpose of financing or refinancing the sale of goods upon an installment basis will vary according to the circumstances of particular transactions, the Board of Governors of the Federal Reserve System believes that certain minimum standards should be observed as a matter of sound banking practice. The examiners for the Federal Reserve Banks should take such standards into consideration in reviewing loans of State-member banks and Federal Reserve Banks in passing upon applications of member banks for credit accommodations supported by obligations issued or drawn for the purpose of financing or refinancing the sale of goods upon an installment basis. The Board recommends that the standards set forth below be applied by all member banks as minimum requirements in making or requiring such loans:

1. Obligations which are issued or drawn for the purpose of financing or refinancing the sale of goods upon an installment basis should be secured by first lien upon or retention of title to such goods through a chattel-mortgage, conditional sales contract, bailment, lease, or other similar instrument insuring at all times the continuance of an effective and lawful lien or retention of title in favor of the holder of such obligations;
(2) The goods should be of such nature and the terms of the obligations should be such that in the event of the resale of the goods at any time during the life of the obligations it may reasonably be expected that the sum realised will be substantially greater than that necessary to liquidate the amount of the obligations then unpaid, including interest and all charges; and

(3) Member banks should take reasonable steps to satisfy themselves that the payments and other requirements of the obligations will be met in accordance with their terms.

STATUTORY PROVISIONS

[Omitted from this draft]