

## FEDERAL RESERVE BANK OF DALLAS

Circular No. 35.

# IMPORTANT

### CHECK CLEARINGS AND COLLECTIONS

May 2, 1916.

#### TO THE MEMBER BANK ADDRESSED:

The Federal Reserve Board has announced that the full provisions of the Federal Reserve Act relating to the clearing and collection of checks will be effective as soon as the Federal Reserve Bank can arrange to handle the volume of business offered, and it has adopted certain definite principles by which the Federal Reserve Banks are to be governed in undertaking the operation of any collection system.—See Federal Reserve Board Circular No. 1, Series 1916, enclosed herewith.

The Federal Reserve Banks have been given much latitude in working out the details of their respective collection systems in order to meet the conditions obtaining in each Reserve District and serve their particular members to the best advantage.

To operate any comprehensive collection system successfully, the Federal Reserve Bank must depend upon its members for facilities to a very large extent. Therefore, it necessarily follows that each member bank should form a working component part of the collection system upon a co-operative basis as a matter of self interest to draw to itself the full measure of benefit possible from the operation of the system as a whole.

While no direct exchange charges on checks received from the Federal Reserve Banks are contemplated, and, under the principles laid down by the Federal Reserve Board, the Federal Reserve Banks are not permitted to pay any exchange charges, a provision has been made to relieve member banks of the direct expense of placing funds with the Federal Reserve Banks to cover any excess of checks received from the Federal Reserve Banks over the amount of checks sent to the Federal Reserve Banks in the natural course of business.

Since exchange charges can only be based on the cost of transporting actual funds equal to the amount of the net difference between items sent out of and received in a given territory, and this cost has been provided for, eventually no hardship will inure to any bank by the waiver of any portion of its former exchange charges on checks. Furthermore, each member bank will be afforded facilities at the Federal Reserve Bank through which it can collect its items without the payment of exchange charges either directly or indirectly. Immediately upon the inauguration of the collection system, all member banks will be given the privilege and encouraged to have printed on all checks of every character drawn on them the following clause:

*“Collectible at Par Through the Federal Reserve Bank of Dallas or Any  
Other Federal Reserve Bank.”*

To facilitate assorting checks member banks of this District are requested to have the number 11 clearly and boldly printed on all their checks and drafts, preferably in large skeleton figures in the center of the check form, although not necessarily in ink of a different color from the other printing on the check. This number should **not**, however, be placed to the left of the center of the check form. The District number should be shown whether or not the clause referred to above is used.

To be of material advantage any collection system must embrace facilities for clearing checks on as great a number of banks as possible, including banks in the United States which are not members of the Federal Reserve System. It is therefore an obvious advantage, not only to the collection system as a whole, but to each member bank, to receive from the Federal Reserve Bank, or for its account, and collect, checks on any State or private bank in its community. Such checks can, of course, be collected through local clearing operations in the usual way, or presented at the counter of the drawee non-member bank and collected in cash, and remitted to the Federal Reserve Bank without expense to the member bank receiving such non-member items.

In routing checks on non-member banks preference will therefore be given member banks located in the same town on which such checks are drawn. When checks on non-member banks are sent to more than one member bank in a town in which a non-member bank is located, the volume of non-member checks will be divided between such member banks in proportion to their subscribed capital in the Federal Reserve Bank.

Collection facilities at par for check on non-member banks in towns where no member bank is located will be developed as rapidly as possible by means of a method already selected.

Restrictions as to endorsements, or otherwise, affecting the eligibility of items will be minimized. **A Federal Reserve Bank will not, however, accept from its member banks items on any District but its own, bearing the endorsement of a bank located in another District.**

The Federal Reserve Bank of Dallas will operate its collection system along the lines of a Clearing House, an outline of which follows:

It will receive in a Clearing and Collection Department, from all of its member banks, checks on all member banks of the entire Federal Reserve System, and checks on all non-member banks in the United States which can be collected at par. A list of such non-member banks, or towns in which they are located, will be furnished and revised from time to time.

Immediate credit will be given to the sending member bank for all items received from it, but this credit will only be immediately available against items sent to such sending banks on the same day, the resultant debit or credit balance, or difference, being entered in the reserve account when collected, or when sufficient time has elapsed for advice of payment to reach us.

A member bank is thus given the opportunity to offset, or in effect to pay, checks on itself at the Federal Reserve Bank, with checks of identical character on other banks to the extent of the amount of checks it sends to the Federal Reserve Bank.

A co-operative plan of settling credit balances will be followed which absolutely equalizes, among all member banks, the interest involved on the net amount of float by reason of items in transit or in process of collection.

Considering, therefore, that all, or a fair proportion, of checks sent to the Federal Reserve Bank will be used to offset checks drawn on the sender, such remittance letter may not be drawn against without the impairment of the reserve balance, thereby necessitating the application of penalties fixed by the Federal Reserve Board. An advice will be forwarded to the member bank showing the amount of difference, on which advice will be shown the approximate date that a credit balance will become available.

Pending the establishment of a service charge by the Federal Reserve Board, a charge of two cents per item, to cover the actual cost of service performed, will be debited monthly

to the accounts of member banks depositing such items. This rate will remain in effect until the actual cost per item can be determined from experience.

No service charge, for the present, will be made on checks drawn on banks in this city **when such items are enclosed in a separate letter.**

For the present, checks on all Federal Reserve Banks, except when drawn as a bank transfer of funds, will be received without service charge, for immediate credit at par in the reserve account, **when enclosed in a separate letter.**

While the following contains the essential details, you will be advised further from time to time concerning other points as they arise in the development of the collection system.

The Federal Reserve Bank of Dallas will inaugurate, within the next few weeks, the exact date to be announced later, a Federal Reserve District Clearing House, and in collecting and clearing items for its members, through its Clearing House Department, **will act as agent only**, and will not become responsible in any manner whatever for the delinquency or default of any bank, and reserves the right to forward checks direct to the banks on which such checks are drawn.

The Clearing House Department will be operated along the following lines:

(1) The Clearing House Department will clear, for the member banks of this Reserve District, checks and drafts drawn upon any other member bank of the Federal Reserve System, also checks and drafts upon such non-member banks in the United States appearing on the list to be furnished member banks.

(2) The total of items received from a member bank will be credited to such member bank on the credit side of the Clearing House balance sheet.

The total of items sent to a member bank will be debited to such member bank on the debit side of the Clearing House balance sheet.

Resultant balances between "Items received" and "Items sent," from and to a member bank, will be settled from each day's settlement sheet in the following manner:

(a) All items received through the Clearing House on a given member bank will be forwarded immediately to said member bank, properly listed and totaled.

(b) The Clearing House will forward to each member interested in the day's clearings an advice showing total of items received from that member, total of items sent to that member, and the resultant credit or debit balance due to or from that member. The advice of a credit balance will indicate the approximate date on which same will be available.

(c) The Clearing House will prepare and send, to each member receiving a debit balance in the day's clearings, an unsigned **settlement check** in the amount of such debit balance, which check shall be drawn against the reserve balance of such member **in the Federal Reserve Bank** and shall be payable to the District Clearing House.

(d) This check must be signed by the proper officer of the member bank and immediately returned to the Clearing House to be apportioned among the creditor banks. If the payment of this settlement check reduces the reserve account of the member bank below the required minimum, the penalty fixed by the Federal Reserve Board will be imposed, unless such member bank accompany said settlement check with a deposit of acceptable funds sufficient in amount to make good the required reserve. After sufficient time has elapsed within which to receive a return of said settlement check, the reserve

account of the member bank will be debited with the amount of the debit balance in the same manner as if the settlement check had been received.

(e) The proceeds of the first settlement checks received from debtor banks will be apportioned to banks receiving the largest credit balance in the clearings of that day, when the second largest, and so on down, each creditor bank receiving credit in its reserve account for its credit balance as soon as debit balances sufficient in amount have been settled. (It does not necessarily follow that the largest banks will receive the largest credit balances, as it is entirely possible that the smallest bank may receive the largest net credit balance in the day's clearings.)

(f) Clearings shall be made on each business day, and neither debit nor credit balances may become cumulative, but each day's clearings must be settled separately.

(g) Advice of all debit balances sufficiently large to warrant such action will be telegraphed to owing banks.

(h) When, in order to meet its settlement checks only, it becomes necessary for a debtor bank to ship lawful money or Federal Reserve notes from its vaults to the Federal Reserve Bank, said debtor bank shall be entitled to and receive the actual minimum cost of transportation of such funds actually shipped, providing advice of such cost accompanies the settlement check, and providing further that such funds are prepared and forwarded under regulations to be established by the Federal Reserve Bank of Dallas. The amount of such cost will be credited to the reserve account of the shipping member.

(i) In the event a member bank receiving a debit balance in the District Clearing House fails to pay such debit balance promptly, or fails to provide funds in its reserve account with the Federal Reserve Bank to meet its Clearing House settlement checks, or suspends payment and is placed in the hands of a receiver, or otherwise becomes unable to meet its obligations on demand, or is otherwise insolvent, then the Federal Reserve Bank will proceed as follows:

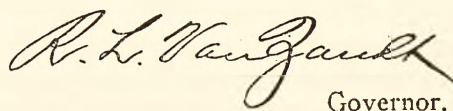
The amount of all items on such defaulting bank which are in process of collection or have been sent to such drawee defaulting bank and for which payment has not been received by the District Clearing House, will be credited to the District Clearing House, and the amount of each item included in such credit will be charged to the reserve account of the member bank endorsing said item to the District Clearing House Department.

(3) Items received from the Clearing House which are dishonored shall be returned by the drawee bank direct to the bank endorsing same to the District Clearing House, and a debit ticket for the amount shall be cleared on such endorser through the Clearing House, carbon duplicate of such debit ticket being attached to such returned unpaid items. These tickets will be in certificate form and may become a part or all of the remittance to the Federal Reserve Bank to cover a Clearing House debit balance.

(4) A slip giving the name of the sending bank and directing wire advice of non-payment should be attached to each item of \$1,000.00 or over at the time it is sent to the Clearing House Department, which instructions must be followed by the receiving bank.

(5) All items of over \$100.00 must be sent subject to protest if not paid.

Respectfully,

  
Governor.

## FEDERAL RESERVE BANK OF DALLAS

### QUESTIONS AND ANSWERS REGARDING CHECK CLEARING

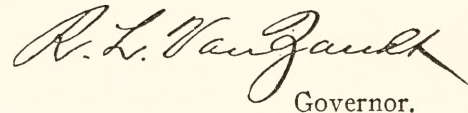
June 2, 1916.

The following questions are compiled from letters received from member banks asking for further information regarding the clearing system which will be fully inaugurated July 15th.

The answers are compiled from our replies to those letters, though somewhat condensed in form.

If there is any further information desired, we shall be glad to answer your inquiries.

Respectfully,

  
Governor.

1 Q. Are member banks compelled to send their items to the Federal Reserve Bank?

A. No.

2 Q. Are member banks required to cover at par checks drawn on them received from the Federal Reserve Bank?

A. Yes.

3 Q. How may checks be covered?

A. By signing and returning the Settlement Check received with the items from the Federal Reserve Bank. This is the only direct form of payment accepted.

The settlement check is drawn on the Reserve Account with the Federal Reserve Bank.

4 Q. Are checks sent to member banks charged to their account, that is, their Reserve Account?

A. They are not when sent, and not until the Settlement Check has been returned and received at the Federal Reserve Bank. However, if the Settlement Check does not reach the Federal Reserve Bank on the day due back, the amount of it will be charged to the Reserve Account.

The Settlement Check is not necessarily for the amount of checks sent to the member bank, but is for the difference between the amount of items received from a member bank and sent to that member bank the same day.

5 Q. How is the Reserve Account to be prepared to meet Settlement Checks and maintained intact at all times?

A. By shipping any form of currency fit for circulation at the expense of the Federal Reserve Bank; by depositing drafts on banks in any **Federal Reserve City only**, at the current market rates, on day of receipt in Dallas, for such exchange; by having deposits or transfers of acceptable funds made by other banks for credit of the Reserve Account; by sending all or a sufficient amount of miscellaneous checks on other points to reduce amount of debit balance or create credit balance in the District Clearing House, in order to disturb the Reserve Account as little as possible; or by rediscounting acceptable paper.

6 Q. How can member banks know the correct state of their Reserve Account on the

books of the Federal Reserve Bank, and what record should they keep of their sendings to the District Clearing House?

A. Daily statements mailed by the Federal Reserve Bank to member banks will show the reserve balance each time the account changes. It is suggested that items sent the District Clearing House be debited to an account styled "District Clearing House of the Federal Reserve Bank of Dallas," and items received from the Clearing House be credited to that account. When debit balances occur the amount of the Settlement Check should be credited to the Reserve Account, against which it is drawn, and debited to the District Clearing House Account to offset the amount credited to that account for items received. Credit balances would be debited on the books of the member bank to the Reserve Account with the Federal Reserve Bank and credited to District Clearing House Account on the date shown by the advice received.

7 Q. Are checks sent to the Federal Reserve Bank credited to the Reserve Account?

A. No, except Federal Reserve city exchange at market rates.

8 Q. May checks sent to the District Clearing House be drawn against?

A. No, because they will be used on receipt at the Federal Reserve Bank to offset, or in effect pay, checks on the sending bank which have been received at the Federal Reserve Bank the same day from other sources. Therefore, there will be no occasion to draw drafts against them.

Banks now draw drafts against checks they send to their correspondents in order to remit for checks received by them from all out-of-town sources.

When all checks on national banks are collectible at par through the Federal Reserve Bank, they will be sent through that channel for collection. Therefore, banks will not be getting checks from any other source than the Federal Reserve Bank and will have infrequent occasion to draw remittance drafts in favor of other banks. Checks sent to the Federal Reserve Bank will be just as available as they are now when sent to correspondents for credit, because they will offset checks on the sending bank without drawing any drafts against checks previously sent correspondents, as is the case now.

9 Q. Can items be handled, as heretofore, through correspondent banks and drafts drawn on them in favor of the District Clearing House to cover checks received?

A. Drafts on correspondent banks, except those on banks in Federal Reserve Cities as above explained, are only available for credit in the Reserve Account when collected, and must be handled through the District Clearing House in the same manner as other miscellaneous items. Those remitted to provide funds to meet Settlement Checks would therefore not serve the purpose on date of receipt.

10 Q. May a member bank draw drafts on the Federal Reserve Bank against excess reserve balance to supply exchange sold over the counter?

A. Yes.

11 Q. When a member bank gets a credit balance in the District Clearing House, is it immediately available?

A. No. Credit balances are paid out of debit balances collected and are available on approximately the date shown on advice. They may be more quickly converted than could the checks which created them.

12 Q. Why?

A. Because a large proportion of the checks sent in serve to pay checks of the same character drawn on the sending bank. It, therefore, swaps checks on outside points for checks on itself, which checks are then charged up to its customers on its books against funds in hand.

13 Q. Are member banks required to pay checks on themselves at Dallas when such checks are only payable over their counter?

A. Member banks are given the privilege of shipping currency or lawful money at the expense of the Federal Reserve Bank to cover checks presented through the mail.

14 Q. Does the deferred availability of a credit balance hamper the creditor bank?

A. No, because by getting a credit balance it follows that the bank has met the checks drawn on it and its current resources have increased sufficiently from deposits of outside checks to carry the small amount of float involved.

Further, the benefit to the creditor bank of the float on a check drawn against the Reserve Account will make up for the time necessary to collect the credit balance in the District Clearing House, where credit balances are drawn against, and there will be slight risk of reserve impairment.

15 Q. What is reserve impairment?

A. A less amount actually to the credit of the Reserve Account of the member bank on the books of the Federal Reserve Bank than the law requires as a minimum balance.

16 Q. What penalty will be imposed for impaired reserves?

A. An interest charge on the average deficiency for the full time deficient.

17 Q. At what rate?

A. Not less than 6%, or always higher than the short time discount rate.

18 Q. By whom are the penalties fixed?

A. By the Federal Reserve Board.

19 Q. Will the Federal Reserve Bank receive from member banks checks on non-member banks?

A. Yes, but for the present only those on non-member banks that will remit at par to the Federal Reserve Bank, or on non-member banks collectible at par through a member bank in the same town, a list of both of which will be furnished.

20 Q. Are member banks required to handle checks on non-member banks in the same town?

A. No, but they will be given the preference if they desire to handle them and will find it of benefit to do so.

21 Q. Will checks be sent direct to the non-member banks agreeing to handle them at par after a member bank in the same town has expressed a desire to receive them?

A. No, unless the non-member bank afterwards becomes a member of the Federal Reserve System.

22 Q. Is the announced service charge of two cents per item a fixed charge?

A. No, it is not, but may vary with conditions and number of items handled. It is, no doubt, the maximum figure, and the ultimate charge will be no more than the actual cost of the service.

There is a certain fixed expense, which must be prorated over the number of items handled, and if the number is small the per item charge will be higher than if a very large number of items were handled.

23 Q. Is two cents per item cheaper than the cost of clearing items at the present time?

A. We think so, vastly cheaper.

24 Q. On what is the above answer based?

A. The fact that large collecting banks have signified their intention to use the collection system because it is cheaper than their present method.

25 Q. Will member banks be expected to send items drawn on points near them to the Federal Reserve Bank, thereby involving circuitous routing and loss of time?

A. No.

26 Q. How will this be avoided?

A. Arrangements will be made and forms furnished to send these items direct to the bank or town on which they are drawn for the credit of the Federal Reserve Bank District Clearing House. The sending bank will advise the District Clearing House the total amount of items so sent.

27 Q. Will there be a service charge on items so handled?

A. Not at present, probably never.

28 Q. Will a similar arrangement be made for handling items on other Federal Reserve Districts?

A. Yes, and no service charge is contemplated unless items on another district are sent to the Federal Reserve Bank of the other district for the credit of the Federal Reserve Bank of which the sending bank is a member, necessitating the handling of the items by the other Federal Reserve Bank.

29 Q. In your opinion, will a member bank carry more, or less, reserve under the new clearing system?

A. Less.

30 Q. Why?

A. It will not have to carry compensating balances to procure collection facilities.

31 Q. Then excess balances with Federal Reserve Banks created by items can be checked out when converted and credited without application of any penalty?

A. Assuredly so.

32 Q. Under such conditions may currency be ordered from the Federal Reserve Bank?

A. Yes, or against reserve credits created by exchange deposited with the Federal Reserve Bank at market rates. The Federal Reserve Bank makes an effort to supply its member banks on request with currency and coin of all kinds and denominations.

33 Q. What arrangements have been made for handling bill of lading drafts?

A. Such drafts when drawn on banks or trust companies will be accepted as checks. When drawn on individuals, firms or other corporations, they will be handled either of two ways:

First. Collected and credited when paid, at actual cost.

Second. Credited immediately on receipt and interest charged depositing bank for the actual time outstanding at the rate applicable to thirty-day paper (at this time 4% per annum), plus actual collection cost.

The check clearing system adopted by the Federal Reserve Bank of Dallas is nothing more nor less than a clearing house conducted along identical lines followed by local clearing houses everywhere.