



FEDERAL RESERVE BANK
OF DALLAS

Dear Sir:-

A few days ago I received an inquiry from one of our Reserve City bankers concerning the effect of our Circular No. 24, which advised the discontinuance, on May 1, 1921, of the purchase by this bank of mail transfers and bank drafts. The points covered in my reply are, in my opinion, of sufficient general interest to all of the City banks in this district to justify their repetition, and I am, therefore, taking the liberty of quoting the substance of my letter with the thought that it may be of some interest or benefit to you. It is as follows:

"In the discussion of this subject, we may first consider the effect of the circular upon the handling of transactions in exchange growing out of the shipment of commodities, or the inter-relations of the commercial and banking enterprises located in widely separated sections of the country.

The fact that the Federal Reserve banks have concluded that it is unwise to capitalize float by continuing to purchase bank drafts and mail transfers, and that such a policy is unwarranted under a strict interpretation of the Federal Reserve Act, does not of course, abolish bank or commercial bills of exchange as a commodity or as a vehicle of the settlement of transactions. Commercial banks will, of course, be called upon to buy either bank or commercial exchange just as they have been heretofore, but need not feel called upon to acquire such exchange in the absence of a specific use for it, either at the time or in the near future after purchase, or in the absence of any occasion, to accept such exchange at an agreed price, based upon its cash equivalent in reimbursement for advances which have been previously made to the parties offering it.

SHEET NO. _____

As a matter of fact, it has been my observation that bank exchange particularly lost much of its commodity phase during the time that it was salable to the Federal Reserve banks, in that transactions in what has been commonly referred to as "Eastern exchange" practically ceased between banks in the settlement of clearings, for currency shipments, etc. Inasmuch as such exchange could be sold to the Federal Reserve Bank at a fixed price, there were no fluctuations in the rate and therefore no bids and offers between banks. If this is true, and I think it is, the discontinuance of the purchase of bank exchange by the Federal Reserve Bank would tend to re-establish an open market for it and banks in this district will very likely, after May 1, offer exchange for sale, or bid for it, according to their demand and use for it or the desire to sell it and convert either sendings on the way or balances already at distant points into a cash equivalent for immediate use.

As an example, your bank on a given day might get a large credit in a local clearing, and one of your neighbors get a debit of more than the amount that it would care to liquidate out of its accrued balance with the Federal Reserve Bank, or in cash. Under such conditions, the debit bank might probably offer Eastern exchange for sale, and your bank, having made its settlement with the Federal Reserve Bank out of accrued credits or in some other manner, might easily acquire it at an agreed price, which would represent an agreeable and sufficient earning rate for the time that you must carry it in transit.

To some extent now, and to a greater extent under more normal conditions, a sort of short investment market might be created along these lines. What you would like to know and solve, undoubtedly, is what attitude you could take toward your bank correspondents in reference to the liquidation of their float comprised of sendings to Eastern points. It should be apparent, and especially under existing conditions, that exchange will only be offered to you if and when your correspondent banks have occasion to make transfers to the Federal Reserve Bank, as far as member banks are concerned, and to remit the Federal Reserve Bank available exchange for

items on them, as far as non-member banks are concerned. The natural conclusion that I am trying to point out is that it is quite unlikely that the offering of exchange to you by bank correspondents would increase their loanable balances with you. It would appear, therefore, only necessary for you to consider the value of the account carried as to whether or not you would desire to extend the facility of making such exchange immediately available and upon such terms as would enable you to either make a profit in the particular transaction, or out of the account generally, or at least to break even.

It is easily conceivable that your bank correspondents may conclude to concentrate with you such items as are ordinarily sent to other points and drawn against, instead of sending them direct and drawing against them as is done at present. This, of course, would be entirely a different matter and would be handled upon the same basis as accounts are now conducted in respect to the requirement of having book balances adequately cover items in transit and the payment of demands against collected funds only. This last phase of the situation would also apply to individual accounts and would require such analysis as would appear necessary to assure this being done.

As a matter of general policy and practice, and particularly in reference to handling accounts of country banks, I do not see how a reserve city bank can escape making its country bank correspondents understand that the forwarding and absorption of Eastern exchange will have to be taken up as special transactions, instead of the correspondent assuming that it is satisfactory to send in its own draft on a correspondent in a distant city and immediately draw through the local clearings, through the Federal Reserve Bank or otherwise, against such remittances; in other words, on offers and bids, and placing such transactions on an open market basis.

As far as your own situation is concerned, and your relations with the Federal Reserve Bank, it would seem desirable to concentrate all sendings, so far as possible, either by making direct remittance for deferred credit, or depos-

iting with the Federal Reserve Bank, or with the Branch, so that you would have continuously, from day to day, maturing credits coming out of your float account to as great an extent as possible. The result of this would probably be that your maturing credits with the Federal Reserve Bank would be in excess of your settlement needs with it, and any excess could be transferred by wire to any correspondent, on an interest basis, as you might elect. If, on the following day there was a similar result, the same action could be taken, but if your maturing credits were not in excess of your settlement needs with the Federal Reserve Bank, or were insufficient to take care of those needs, then wire transfers could be effected to the Federal Reserve Bank out of balances to which transfers had been made the previous day, or out of other collected funds with such correspondent.

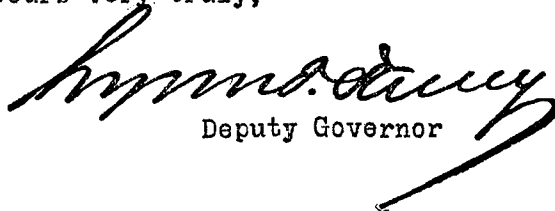
To meet emergencies, arising from the fact that maturing credits on a given day were not sufficient to take care of settling needs, and due to the time of day or a lack of collected balances with correspondents preventing wire transfers to be made, you could lodge with the Federal Reserve Bank or Branch, your own collateral notes in convenient amounts of say \$50,000, signed but not dated, and with the maturity date left blank, together with eligible and acceptable collateral, to be passed upon and held subject to your instructions. If then, for example, you lacked \$100,000 of having enough to settle, without impairment of your reserve, you could call on the Federal Reserve Bank or Branch, date and insert the maturity in two of the \$50,000 notes, which would be available for discount and credit on the same day. If you had in transit on the way to New York, for instance, sufficient remittances to cover this amount, the two notes could be made to mature in four days and could be liquidated by wire transfer out of the proceeds of the remittance in transit to New York on the day that the notes were completed and put through. In our circular No.24, we touched upon the possibility of having reimbursement drafts, either against commodities shipped or sales of foreign exchange, made to read "four days after date" in the case of drafts drawn on New York, and "three days after date" in the case of drafts on Chicago. Under these circumstances such drafts would be eligible for discount under the terms of our Circular No.20, Series of 1918, and the provision of this facility would seem to take your cotton drafts particularly entirely out of the realm of your difficulties. Such drafts need not be forwarded to New

York by you but could be offered to us for discount and if accepted, the proceeds could be transferred by wire to any interest bearing balance you might desire if in excess of your settling needs for that day. The drafts discounted in this manner with us would be forwarded the same day to the point drawn on, for collection, and if paid, would liquidate themselves.

I believe that I have touched upon all the elements in the situation that will be presented after May 1. I appreciate that it will take some little time to complete the transition from the old method to the new and realize that the country banks have probably not attached the importance to our circular that it deserves, and in view of the fact that they have been accustomed heretofore to sending their drafts to their reserve city correspondents, they probably feel that the circular announcing the change in policy does not affect them materially. Under these circumstances, I am sure that you will find it necessary to take on remittances of their exchange until an opportunity is afforded to advise them upon what basis it will be accepted by you in the future."

If there are any points not brought out in the foregoing, or which are not perfectly clear to you, I will be pleased to have you write me with reference to same, and beg to assure you of my willingness to render you such assistance as I can in working out your problems which will be brought about by our change of policy.

Yours very truly,


Deputy Governor