

FEDERAL RESERVE BANK
OF DALLAS

Circular No. 2
Series of 1925
Supplementing Circular No. 1
Series of 1924

January 16, 1925.

NOTE FORMS

To the Member Bank Addressed:

Reference is made to our Circular Number 1, Series of 1924, addressed to all member banks on February 4, 1924. Due to the fact that there has been some confusion on the part of member banks in regard to the negotiability of paper offered to us, it has been deemed advisable to issue this circular by way of supplementing our Circular Number 1, Series of 1924.

The Federal Reserve Board, in Section II of Regulation A, Series of 1924, prescribes as a primary requisite for eligibility that a note be negotiable.

From the foregoing it is obvious that the first test which the Federal Reserve Bank of Dallas must apply to notes offered it is that of negotiability; and although a note may contain provisions which a member bank regards as affording additional protection, if such provisions destroy the negotiability of the note, it is not eligible for discount with this bank.

While it would not be practical in a communication of this kind to enter into a full discussion of the various elements of negotiability, we have thought it would be helpful to our member banks, in order that they might understand our viewpoint on this subject, to call attention to some of the most important elements of negotiability.

Section I of the Negotiable Instruments Act provides:

“An instrument to be negotiable must conform to the following requirements:

1. It must be in writing and signed by the maker or drawer;
2. It must contain an unconditional promise or order to pay a sum certain in money;
3. Must be payable on demand, or at a fixed or determinable future time;
4. Must be payable to order or to bearer; and
5. Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty.”

Section V provides in part:

“An instrument which contains an order or promise to do any act in addition to the payment of money is not negotiable.”

Clauses making the negotiability of a note doubtful, which are most commonly used, appear to be at variance with sub-paragraph three of Section I or the quoted portion of Section V of the Negotiable Instruments Act; and as illustrations we submit the following:

“Said bank may apply to payment of this note any money or credits on deposit with it to credit of either signer hereof at any time before or after maturity.”

“Full authority is hereby given to the payee hereof or its assignees to declare this note due at any time they may deem themselves insecure even before maturity.”

“I hereby give the said holder or his attorney or agent authority to sell at the maturity of this note or at any time before the maturity if in the judgment of said holder * * *.”

“* * * shall not be responsible for any depreciation in the value of such securities hereby pledged but in the event the same shall depreciate to such an extent as that in the opinion of the president or cashier of said bank same are insufficient to fully secure this note, upon demand of any officer of said bank, we will within twenty-four hours furnish additional security to the entire satisfaction of said bank, and in the event of failure to furnish such additional security said bank may proceed at once to sell the securities herein pledged in the same manner as if this note had matured by lapse of time.”

“* * * that all collateral securities pledged for the payment of this note or which may hereafter be pledged for such payment shall be applicable to any other indebtedness owing by the maker of this note. * * *”

The Negotiable Instruments Act, being new, has not as yet been fully construed by the courts of the various states in this district. Consequently, there are many points affecting the negotiability of a note over which well-informed attorneys will differ. It is the practice of this bank when any such points arise, touching a note offered to us, to hold that the note is not acceptable until the point has been affirmatively decided by the courts of the state in which the note originated.

After the issuance of our Circular Number 1, Series of 1924, above referred to, a very large number of our member banks forwarded to us the note forms which they used, with the request that we advise them whether or not they were acceptable. On account of the stress of other business, our legal department was unable to handle this large volume of work promptly, with the result that many member banks did not receive a prompt reply and thus, in some instances, suffered inconvenience. If any member bank desires to submit to us for inspection the note form it is now using or proposes to use, it is requested

SPECIMEN FORM

Refers to Circular No. 2
Series of 1925

....., 192.....

The Undersigned, contemplating doing business with the....., agrees with said bank, as the basis of said business, as follows:

That any and all securities now or hereafter at any time pledged with said bank to secure any debt or liability from..... to said bank, shall be held and construed to be pledged hereunder, and may be held by said bank as security for any and all debts and liabilities to said bank for the payment of money, whether such debts and liabilities now exist or are hereafter incurred or arise, and whether..... obligation or liability thereon be direct, contingent, primary, secondary, joint, several, joint and several, or otherwise.

That upon..... failure to keep and perform any agreement hereinafter contained or in case of..... insolvency or failure in business, said bank may at its option at once mature all debts and liabilities hereby secured.

That..... will pay the debts and liabilities hereby at any time secured when same become due and payable, whether same mature according to the terms of the contract evidencing same or by exercise of aforesaid option by said bank.

That said bank shall not be liable for failure to use due diligence to collect or to fix or preserve the liability of any party to any security at any time held in pledge hereunder, but shall only be liable for what it actually collects or receives thereon.

That if the securities at any time held in pledge hereunder shall decline in value..... will, on demand, forthwith make payment on the debts and liabilities then secured hereby or deposit additional securities hereunder to the satisfaction of said bank.

That upon failure to keep and perform any agreement herein contained, said bank or its assigns is authorized and empowered, without either demand, advertisement or notice of any kind, to sell at public or private sale at..... the whole or any part of the securities then held by it in pledge hereunder and transfer and deliver same to the purchaser or purchasers thereof, and receive the proceeds of sale. Said bank to have the right to purchase at said sale as a stranger. Sale of part of securities held in pledge hereunder shall not exhaust this power of sale, but sales may be made from time to time until all securities are sold or debts and liabilities hereby secured paid in full. Said bank shall receive the proceeds of such sale or sales, which shall be paid and credited on said debts and liabilities then secured hereby, said bank to have option of application thereof. Any surplus after payment in full of said debts and liabilities to be paid to.....

This instrument and all rights and powers hereunder, together with the securities then held in pledge hereunder, may be transferred and assigned by said bank at such time and upon such terms as it may deem advisable; and such assignee shall succeed to all the rights and powers of said bank hereunder.

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SPECIMEN FORM

Refers to Circular No. 2

Series of 1925

No. 192 \$

..... AFTER DATE, I, WE, OR EITHER OF US, PROMISE TO PAY TO THE ORDER OF

.....
.....
..... at its banking house in

..... DOLLARS

for value received with interest from at the rate of per cent per annum until
paid. If this note is not paid at maturity and is placed in the hands of an attorney for collection, we agree
to pay ten per cent of the principal and interest due hereon in addition hereto as attorney's fees.

We, the makers, endorsers, guarantors, assignors and sureties, severally waive presentment for pay-
ment, protest and notice thereof, and diligence in collecting.

Due


Address

that before doing so it refer the form to its own attorney with a view of having him carefully consider it and eliminate all provisions which might adversely affect its negotiability.

We are attaching to this circular a note form which has been approved by our Counsel as eligible from the standpoint of negotiability. There is also attached a collateral pledge form which, when executed separately and not made any part of the note, is acceptable to us, in cases where the note is secured by the pledge of collateral. Any other note form which does not contain the objectionable features mentioned above, or other conditions or provisions which would raise questions of negotiability, would meet our requirements.

WE RECOGNIZE THAT THE FORM OF NOTE WHICH A MEMBER BANK SHOULD USE IS A MATTER WHOLLY WITHIN THE DISCRETION AND DETERMINATION OF ITS OFFICERS AND DIRECTORS, AND THE ONLY PURPOSE OF THIS CIRCULAR IS TO ACQUAINT OUR MEMBERS WITH OUR REQUIREMENTS IN CONNECTION WITH PAPER SUBMITTED TO US FOR DISCOUNT OR COLLATERAL.

Yours very truly,

A handwritten signature in cursive script, appearing to read "B. A. McKinney".

Governor.