Circular No. 1
Series of 1930

FEDERAL RESERVE BANK OF DALLAS

January 22, 1930.

SUBJECT: Indebtedness incurred through the Purchase of Federal Reserve Funds

To the Member Bank Addressed:

For the information of those of our member banks (principally in the larger centers) who make it a practice, in replenishing their reserve balances, to purchase temporary Federal reserve funds from neighbors or correspondents who have an excess thereof, we quote the following ruling of the Federal Reserve Board contained in its letter No. X-6443, dated January 2, 1930, entitled "Liability Incurred by Member Banks in Purchasing Federal Reserve Exchange."

"In a ruling published in the Federal Reserve Bulletin for September, 1928, at page 656, the Federal Reserve Board held that the liability incurred by a member bank through the issuance of its cashier's check for Federal reserve exchange purchased, should be treated as a liability for money borrowed rather than as a deposit liability. The facts of the transaction which were under consideration by the Board at that time were described as follows:

"A member bank which is temporarily short in its reserves arranges with another member bank having a temporary excess in reserves for the use of a stipulated amount of Federal reserve credit, for one day or more, as may be agreed upon. The bank purchasing the credit either gives its cashier's check to the selling bank, to be held for one day or more, as the case may be, or, dispensing with the formality of issuing a cashier's check, authorizes the selling bank to clear a ticket for the amount through the clearing house settlement on the day agreed upon, and the selling bank either gives its draft on the Federal reserve bank to the buying bank or arranges with the Federal reserve bank to transfer on the Federal reserve bank's books the stipulated amount from the account of the selling bank to the account of the buying bank.

"It now appears that, while Federal reserve exchange is frequently purchased and sold in accordance with the method above described, this practice is not universally followed and it often happens that a member bank purchases Federal reserve funds from another member bank through the method of book entries, wire transfers or otherwise. The question has been presented to the Board as to how such transactions should be regarded in cases where the purchase and sale of Federal reserve exchange is accomplished by some method other than that described in its 1928 ruling.

"After considering this question the Board is of the opinion that all such transactions should be classified in accordance with the purpose to be effected and the principles involved rather than in accordance with the mechanics of their accomplishment. Transactions of this kind are manifestly temporary loans negotiated for the purpose of avoiding the necessity of rediscounting with the Federal reserve bank or showing a deficiency in reserves. The Board rules, therefore, that in every such transaction whether effected by check, book entries, wire transfers or otherwise, and regardless of the method of repayment, the purchasing member bank should show its resulting liability to the selling member bank as money borrowed and the selling member bank should treat the transaction as a loan made. In using the Board's Form 105 for report of condition, the purchasing member bank should show the liability incurred in any such transaction under 'bills payable and rediscounts' and the selling member bank should enter the amount of the transaction under 'loans and discounts.'"

The Board's form 105, report of condition, referred to in the last sentence of the letter quoted above, is used only by state member banks in making reports to the Federal Reserve Board. Treasury Department form 2130, call report of condition, is used by national banks in making reports to the Comptroller of the Currency. Likewise, in making call reports on this form, the purchasing bank should show such liability against the item, "Bills payable and rediscounts," and the selling bank should include the amount under the item "Loans and discounts."

It is of course realized that only a small number of our member banks engage in this practice, but in line with our usual custom, this circular is nevertheless being sent to all member banks for their information.

Yours very truly,

Lynn P. Talley

Governor.

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