

At a meeting of the Federal Reserve Board held in the office of the Board at 10.45 a. m. Friday, September 3d,

PRESENT:

Mr. McAdoo, presiding, Mr. Warburg

Mr. Hamlin Mr. Harding

Mr. Williams Mr. Miller

Mr. Willis, Secretary.

PRESENT ALSO:

Mr. Benjamin Strong, jr., Governor,
Federal Reserve Bank of New York.

Mr. J. F. Curtis, Counsel of the same.

After discussion it was agreed that the Federal Reserve Bank of Boston be instructed that its capital stock is to be carried at a book value of par until the end of the fiscal year, December 31, 1915 expenses being separately accounted for in the meantime.

Mr. McAdoo called up for further discussion, Regulation J, which had been made a special order at the meeting of Thursday afternoon, September 2d, there being before the Board the motion of Governor Hamlin for the general adoption of Governor Strong's proposed changes in the regulation. Mr. Warburg laid before the Board a memorandum in which he dis-

cussed the proposed changes put forward by Mr. Strong
as follows:

MEMORANDUM COVERING GOVERNOR STRONG'S PROPOSED AMENDMENT:

There is no objection to striking out the word
"banking" under IV (b).

IV (c) The proposed amendment, particularly when considered in connection with the amendment of IV (f), goes much further than appears to be required for the Brown transaction. This is the case in two respects: first, by eliminating the words "commercial, industrial or agricultural concern" and substituting therefor the words "purchaser or seller or other person" directly connected with the importation or exportation, the door is thrown open to drafts drawn by foreign governments or their representatives. Paper of this kind has generally been held as not desirable paper for banks of the character of a Federal Reserve Bank. It would particularly be the case where the right is given to renew these bills indefinitely and where, as proposed under (f), other securities - that is to say Government bonds or other stocks and bonds - may be deposited as collateral, not as substitution for the original shipping documents but as collateral right from the beginning. In other words, the Argentine government might deposit its government bonds with some American bank and draw upon the American bank for three months, continuing this transaction indefinitely, the proceeds of the first draft having been sold in the market by someone who used these proceeds for the payment of goods to be exported. Second, by striking out the paragraph following the word "banker", clause (c) a similar situation is being created with respect to a bank which is drawing the bill. As Mr. Strong words this paragraph, the banker need not have any connection at all with the purchaser of the goods or with the transaction involved. Just as outlined in the case of the Argentine government, any banker in the United States or in a foreign country could draw upon an American banker, depositing any kind of collateral and renewing the bills indefinitely, provided the original proceeds had been used by someone in payment of goods to be imported or exported.

I think it is most important that the Board should clearly recognize the bearing of the amendments here proposed.

The amendment as proposed by me provides for all necessities of the Brown credit, but its purpose is to preserve the connection with the original transaction of importation or exportation so that plain finance drafts secured by bonds and stocks be eliminated, as to my mind this was the intention of the Act.

As to Government credits, the amendment as proposed by me would enable any foreign government to buy whatever it pleased by using the instrument of some commercial firm or of its banks, as in the case of the Brown credit. It is to be borne in mind that if an accepting bank fail, the Federal Reserve Banks would be in the somewhat difficult position of having to sue a foreign government in case the draft had been issued by a government direct, a situation which can easily be avoided without the least interference with the fullest development of our commerce and trade. If the Board should decide, however, that it wishes to open the door for such drafts by foreign governments, it is suggested that the following wording would be preferable to that proposed by Governor Strong, inasmuch as it establishes the connection of the banker with the importation or exportation of goods:

"A banker's acceptance must be drawn by the purchaser or seller of the goods, upon the importation or exportation of which is based the transaction from which the acceptance originated, or by some person, firm, company or corporation directly connected with said transaction or acting as agent or as banker for the purchaser or seller."

If, as suggested by Mr. Strong, the last two sentences of clause (c) be stricken out, our regulations contain nothing about renewals and it will be necessary, of course, upon request of the banks in that case, to give a separate ruling about these renewals. I would suggest, therefore, for the consideration of the Board whether it would not be preferable to

add at the end of this clause after the clause herein suggested, as follows:

"The bill must not be renewed after the goods have been surrendered to the purchaser or consignee except for such reasonable period as may have been agreed upon at the time of the opening of the credit as a condition incidental to the importation or exportation involved."

There is no objection to the changes proposed in (g) and (h) except that it is my belief that if the Board makes unnecessary changes in this regulation, it will be said by one side or the other that these changes had been made for the purpose of being of assistance to certain parties, and the Board is certain to be attacked on these lines. The more closely we adhere to the lines originally adopted, the stronger our position will be, provided that the Board does not by anything that it does or leaves undone, interfere with the legitimate requirements of the situation.

This is one of the reasons why I should think they would be in favor of the policy outlined by me.

The change in the last paragraph of IV is so radical that it needs no further elaboration on my part. It means that the Federal Reserve Banks may buy any acceptance they please; also those made by non-member banks, for the financing of domestic transactions. While it may well be that the ultimate development may lead us in this direction, I believe it is well worth while carefully to consider whether this radical step should be taken at this time.

General discussion ensued, Mr. Strong being asked to explain his reasons for the proposed changes. Mr. Strong stated that in general he considered the whole regulation of the Board unduly restrictive upon operations of the Federal reserve banks. Commenting upon Mr. Warburg's memorandum he

said it was true that the proposed changes would open the way to the undertaking of business with foreign governments, but he thought that there was nothing in the act inconsistent with such transactions. If the member banks have the right to accept paper of any character, he said, they would also have a right to rediscount acceptances thus taken, otherwise member banks would soon be filled up with paper which was non-rediscountable. In the same way governments ought to be allowed to draw, and to use the same kind of commercial instruments that are used by private citizens in conducting trade. Otherwise they would have to do business on a basis different from that which had already been developed in the course of private business experience.

Secretary McAdoo broadly endorsed this view and expressed himself in favor of anything that would help to finance export trade.

Mr. Miller said that he desired to finance all trade on a sound business basis. He thought, however, that the Board would have a serious cause for regret should it allow itself to be governed in its general policies by conditions that were purely temporary and

would before long pass away. He was willing to provide for the renewal of acceptances if necessary and for the rediscount of such acceptances with Reserve Banks, but he would not go further than was absolutely necessary to meet the present situation. He would not be willing to take any action that would commit the Board to a future policy.

The Board should be careful at all times not to allow itself to be misled into the adoption of questionable policies, particularly those out of harmony with the spirit of the Federal Reserve Act under the plea of necessity. The present proposals, Mr. Miller, added, seem to be inconsistent with the policies and principles laid down by the Board in its first report and in its subsequent regulations.

Mr. Harding thought that it was fundamentally necessary to keep the export trade of the country up to as high a level as possible and in order to accomplish this end, some form of credit must be arranged to sustain it. As to drafts of foreign governments he said that it was a fact that such governments were assisting private concerns in their own countries; they were helping to finance given industries. This was really the same in essence as the

governments' giving its endorsement to its own importers. Conditions had changed since the Act was drawn and even since the existing regulation had been drafted. That made it necessary to adapt the rules to the changed conditions.

Mr. Strong in closing said that it seemed to be the fear of some that the acceptance power would be abused. He could assure the Board that there was no danger of such result. The banks of New York had had the unrestricted right to accept for some months, very few having abused it. Even where such abuse had occurred, it very quickly corrected itself because no one would buy acceptances that were unwisely made.

Governor Hamlin discussed the question of prime bills and asked Mr. Strong his view with reference to the different classes of bills in use abroad. Mr. Strong outlined the different classes of bills in use and emphasized the view that all classes of bills, except accommodation paper, whether documentary or not, if they were "prime" were currently accepted by English banks and taken by the Bank of England.

At this point Mr. Strong and Mr. Curtis

withdrew from the meeting.

After further discussion a vote was called for on the amendment provision (c) reading as follows:

(c) A banker's acceptance must be drawn by a commercial, industrial, or agricultural concern (that is, some person, firm, company or corporation) directly connected with the importation or exportation of the goods involved in the transaction in which the acceptance originated, or by a "banker". In the latter case the goods, the importation or exportation of which is to be financed by the acceptance, must be clearly specified in the agreement with or the letter of advice to the acceptor. The bill must not be drawn or renewed after the goods have been surrendered to the purchaser or consignee.

On motion it was agreed to accept the amendment as thus provided with an addition making it read as follows:

A bankers' acceptance must be drawn by a purchaser or seller or other person, (firm, company or corporation) directly connected with the importation or exportation of the goods involved in the transaction in which the acceptance originated, or by a "banker". The bill must not be renewed after the bills have been surrendered to the purchaser or consignee except for such renewal period as may have been agreed upon at the time of the opening of the credit as a condition incidental to the importation or exportation involved, provided that the bill must not contain or be subject to any agreement whereby the holder thereof is obligated to renew the same at maturity.

Mr. Strong's amendment to sub-section (d) with somewhat further modification was adopted so as to make the sub-section read as follows:

(d) A banker's acceptance must bear on its face or be accompanied by evidence in form satisfactory to a Federal Reserve Bank that it originated in or is based upon a transaction or transactions involving the importation or exportation of goods. Such evidence may consist of a certificate on or accompanying the acceptance to the following effect:

This acceptance is based upon a transaction involving the importation or exportation of goods. Reference No. _____ Name of acceptor. _____

The other amendments proposed by Governor Strong in sub-section (e), (f), (g) and (h) were on motion all adopted as proposed. The subsequent amendment proposed by Mr. Strong in the text of the regulation were defeated, so that the revised text of the regulation as agreed upon read as follows:

REGULATION R, SERIES OF 1915.

(Superseding Regulation J of 1915.)

Washington, September 7, 1915.

BANKERS' ACCEPTANCES.

I Definition.

In this regulation the term "acceptance" is defined as a draft or bill of exchange drawn to order, having a definite maturity, and payable in dollars, in the United States, the obligation to pay which has been accepted by an acknowledgment written or stamped and signed across the face of the instrument by the party on whom it is drawn; such agreement to be to the effect that the acceptor will pay at maturity according to the tenor of such draft or bill without qualifying conditions.

II Statutory requirements under sections 13 and 14.

Section 13 of the Federal Reserve Act as amended provides that -

(a) Any Federal reserve bank may discount acceptances -

(1) Which are based on the importation or exportation of goods;

(2) Which have a maturity at time of discount of not more than three months; and

(3) Which are indorsed by at least one member bank.

(b) The amount of acceptances so discounted shall at no time exceed one-half the paid-up capital stock and surplus of the bank for which the rediscounts are made, except by authority of the Federal Reserve Board and of such general regulations as said Board may prescribe, but not to exceed the capital stock and surplus of such bank.

(c) The aggregate of notes and bills bearing the signature or indorsement of any one person, company, firm or corporation rediscounted for any one bank shall at no time exceed 10 per cent of the unimpaired capital and surplus of said bank; but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.

Section 14 of the Federal Reserve Act permits Federal reserve banks, under regulations to be prescribed by the Federal Reserve Board, to purchase and sell in the open market bankers' acceptances, with or without the indorsement of a member bank.

III Ruling.

The Federal Reserve Board, exercising its power of regulation with reference to paragraph II (b) hereof, rules as follows:

Any Federal Reserve bank shall be permitted to discount for any member bank "bankers' acceptances" as hereinafter defined up to an amount not to exceed the capital stock and surplus of the bank for which the rediscounts are made.

IV Eligibility.

The Federal Reserve Board has determined that, until further order, to be eligible for discount under Section 13, by Federal reserve banks, at the rates to be established for bankers' acceptances:

(a) Acceptances must comply with the provisions of paragraph II (a), (b), (c) hereof.

(b) Acceptances must have been made by a member bank, nonmember bank, trust company, or by some firm, person, company, or corporation engaged in the business of accepting or discounting. Such acceptances will hereafter be referred to as "bankers'" acceptances.i

(c) A banker's acceptance must be drawn by a purchaser or seller or other person, firm, company, or corporation directly connected with the importation or exportation of the goods involved in the transaction in which the acceptance originated, or by a "banker." The bill must not be renewed after the goods have been surrendered to the purchaser or consignee, except for such reasonable period as may have been agreed upon at the time of the opening of the credit as a condition incidental to the importation or exportation involved, provided that the bill must not contain or be subject to any condition whereby the holder thereof is obliged to renew the same at maturity.

(d) A banker's acceptance must bear on its face or be accompanied by evidence in form satisfactory to a Federal reserve bank that it originated in, or is based upon, a transaction or transactions involving the importation or exportation of goods. Such evidence may consist of a certificate on or accompanying the acceptance to the following effect:

This acceptance is based upon a transaction involving the importation or exportation of goods. Reference No. _____ Name of acceptor _____.

i. Drafts and bills of exchange eligible for rediscount under Section 13, other than "bankers" acceptances, have been dealt with by Regulation B, series of 1915.

(e) Bankers' acceptances, other than those of member banks, shall be eligible only after the acceptors shall have agreed in writing to furnish to the Federal reserve banks of their respective districts, upon request, information concerning the nature of the transactions against which acceptances (certified or bearing evidence under IV (d) hereof) have been made.

(f) A bill of exchange accepted by a "banker" may be considered as drawn in good faith against "actually existing values" under II (c) hereof, when the acceptor is secured by a lien on or by transfer of title to the goods to be transported or by other adequate security.

(g) Except in so far as they may be drawn in good faith against actually existing values, as under (f), the bills of any one drawer drawn on and accepted by any firm, person, company, or corporation (other than a bank or trust company) engaged in the business of discounting and accepting, and discounted by a Federal reserve bank, shall at no time exceed in the aggregate a sum equal to a definite percentage of the paid-in capital of such Federal reserve bank; such percentage to be fixed from time to time by the Federal Reserve Board.

(h) The aggregate of acceptances of any firm, person, company, or corporation (other than a bank or trust company) engaged in the business of discounting or accepting discounted or purchased by a Federal reserve bank, shall at no time exceed a sum equal to a definite percentage of the paid-in capital of such Federal reserve bank; such percentage to be fixed from time to time by the Federal Reserve Board.

To be eligible for purchase by Federal reserve banks under section 14, bankers' acceptances must comply with all requirements and be subject to all limitations hereinbefore stated, except that they need not be indorsed by a member bank: Provided, however, That no Federal reserve bank shall purchase the acceptance of a "banker" other than a member bank which does not bear the indorsement of a member bank, unless a Federal reserve bank has first secured a satisfactory statement of the financial condition of the acceptor in form to be approved by the Federal Reserve Board.

V Policy as to purchases.

While it would appear impracticable to fix a maximum sum or percentage up to which Federal reserve banks may invest in bankers' acceptances, both under Section 13 and Section 14, it will be necessary to watch carefully the aggregate amount to be held from time to time. In framing their policy with respect to transactions in acceptances, Federal reserve banks will have to consider not only the local demands to be expected from their own members, but also requirements to be met in other districts. The plan to be followed must in each case adapt itself to the constantly varying needs of the country.

The precise form to be given to the circular accompanying the regulation was referred to a special committee consisting of Mr. Harding and Mr. Miller, and the same action was taken with reference to the circular to accompany the commodity rate regulation.

The Secretary of the Board was directed to give the commodity paper circular and regulation to the press for publication in the papers of Saturday morning, with an accompanying statement. //

On motion it was voted to approve a commodity paper rate of 3% for Atlanta, the same having been proposed by the Atlanta bank by telegraph. The Secretary was also authorized to inform the Federal Reserve Banks of Dallas and Richmond of the action taken and it was agreed that in the event that these two banks should apply for a 3% commodity rate it should be extended to them. //

// The Governor of the Board presented a letter from Governor Strong of New York making specific inquiry as to the eligibility of certain acceptances made under a certain contract of Brown Brothers providing for a credit of \$20,000,000 in the United States. It was agreed that in reply the Board should simply say that the new regulation, copy of which should be enclosed, would answer the question. //

Secretary McAdoo informed the Board that he had directed that deposits of \$15,000,000 (\$5,000,000 each at Richmond, Atlanta and Dallas) be made of Government funds for cotton moving, and stated that he would give out an announcement to this effect simultaneously with the Board's commodity paper announcement.

On motion at 1:45 p. m. the Board adjourned to meet on Wednesday, September 8, at 11:00 a. m.

A. Parker Willis
Secretary.

APPROVED:

Chairman.