

F E D E R A L R E S E R V E B O A R D
WASHINGTON

January 5th, 1915.

My dear Governor:-

I have your letter of the fourth instant asking for an interpretation by this office of that part of Section Sixteen of the Federal Reserve Act which reads as follows:

"Any Federal reserve bank may at any time reduce its liability for outstanding Federal reserve notes by depositing, with the Federal reserve agent, its Federal reserve notes, gold, gold certificates, or lawful money of the United States. Federal reserve notes so deposited shall not be reissued, except upon compliance with the conditions of an original issue.

The Federal reserve agent shall hold such gold, gold certificates, or lawful money available exclusively for exchange for the outstanding Federal reserve notes when offered by the reserve bank of which he is a director. Upon the request of the Secretary of the Treasury the Federal Reserve Board shall require the Federal reserve agent to transmit so much of said gold to the Treasury of the United States as may be required for the exclusive purpose of the redemption of such notes".

The question for determination, as I understand it, is whether or not Federal reserve banks may deposit lawful money for the retirement of Federal reserve notes issued to such bank when the notes to be retired are still in the possession of the bank making the deposit. This question involves a construction of the language "outstanding Federal reserve notes". Does this mean notes which have left the possession of the Federal reserve agent, or does it have reference to notes which have been placed in actual circulation by the Federal reserve bank and have left the possession of such bank?

In a purely technical sense Federal reserve notes which are obligations of the United States Government become outstanding obligations when the Federal reserve agent delivers them to the bank applying therefor, and where this language is used in other parts of the Act it should probably be given this construction. In the present instance,

however, the Federal reserve bank obtaining such notes is one of the places of redemption. Accordingly, the term "outstanding" appears to be used in the statute in a dual sense. That is to say, it refers to those notes which are outstanding obligations of the United States when they have left the possession of the Federal reserve agent, and also to those notes which become outstanding liabilities of a Federal reserve bank when they have left the possession of the Federal reserve bank. This is indicated by that part of the Act which in referring to such notes, reads

"They shall be redeemed in gold on demand at the Treasury Department of the United States, or in gold or lawful money at any Federal reserve bank".

In order for such notes to be offered for redemption at any Federal reserve bank, it is necessary for them to be in actual circulation and not in possession of such Federal reserve bank. It is necessary, in construing this language, to consider this distinction.

It will be observed, as stated, that these notes are redeemed by presentation to the Treasurer at Washington, or by presentation to the Federal reserve bank, and the Federal reserve bank in turn presents them to the Federal reserve agent for exchange for lawful money deposited by the Federal reserve bank.

This being true, it was evidently contemplated by Congress that any Federal reserve bank desiring to reduce its liability for Federal reserve notes which are outstanding obligations of the United States, that is to say - Federal reserve notes which have left the possession of the Federal reserve agent, may deposit with the Federal reserve agent any Federal reserve notes in its possession. Having done this, if it desires to further reduce its liability for outstanding Federal reserve notes, that is to say - Federal reserve notes which have left the possession of the Federal reserve bank, it may do so by depositing gold or lawful money with the Federal reserve agent.

In this latter case, whenever Federal reserve notes are presented to the Federal reserve bank for redemption, after it has deposited lawful money with the Federal reserve agent to reduce its liability, the Federal reserve bank receiving such notes should immediately present them for redemption to the Federal reserve agent and receive in exchange therefor the lawful money so deposited.

The Federal reserve agent is required, as above stated, to hold the lawful money deposited available exclusively for the redemption of such Federal reserve notes when presented by the Federal reserve bank and in order for him to use the funds so deposited for the purpose for which they are deposited, it is a condition precedent that the Federal reserve bank should present notes coming into its possession for exchange. The Federal reserve bank in such case, having discharged its liability, should not be permitted to put back into circulation any such notes coming into its possession but should be required to present them for redemption as the statute clearly contemplates.

It will be recalled that banks are expected to pay the rate of interest on such notes fixed by the Federal Reserve Board, and it is to be assumed that no bank having in its possession Federal reserve notes and lawful money would deposit the lawful money with the Federal reserve agent and continue to pay interest charged on the Federal reserve notes.

A regulation requiring the presentation of such notes to the Federal reserve agent when they come into the possession of the Federal reserve bank under such circumstances would, therefore, seem to be entirely in accord with the purposes and intent of this Act.

Respectfully,

(Signed) M. C. Elliott

Counsel.

Hon. Charles S. Hamlin,
Governor, Federal Reserve Board.