

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

Washington.

January 4, 1915.

My dear Governor:

By direction of the Board, the Secretary has referred to this office for an opinion that portion of the report of the Advisory Council submitted by Mr. J. B. Forgan, President, which deals with the subject of check clearings. The part of the report referred to reads as follows:

"Check Clearings.

The Federal Advisory Council is unable at present to make definite suggestions on this subject.

As a preliminary the Federal Reserve Board or its counsel should determine whether under Sections 13 and 16 of the Federal Reserve Act, Federal reserve banks are either permitted or required to receive on deposit from their depositors checks drawn upon member banks or Federal reserve banks of other districts. As the Council reads these sections such checks can only be received on deposit by a Federal reserve bank "when remitted by" another Federal reserve bank and then solely for exchange purposes. In the opinion of the Council it is unsound in principle and wrong in practice that a check drawn on a member bank should be charged to its reserve account with a Federal reserve bank without its authority and without its having had an opportunity to pass upon it. The Council fears that the attempt being made by some of the Federal reserve banks to disregard the elements of time and distance in connection with the clearing of bank checks may so involve and absorb the funds of the Federal reserve banks as to seriously impair their usefulness as banks of issue and discount."

It will be observed that two questions are presented for consideration -

First, Can a Federal reserve bank, under the terms of the Act, be permitted or required to accept on deposit checks and drafts drawn against banks which are members of other Federal reserve banks.

Second, Can a Federal reserve bank, receiving on deposit or by remittance from another Federal reserve bank checks or drafts drawn against one of its member banks,

charge up such checks or drafts against the reserve or deposit account of a member bank without instructions or authority from such member bank.

While these two questions may be said to be related, or at least that both are to be considered as part of the general subject of clearances, the legal questions involved are distinct and they should be considered separately.

The first question involves an interpretation of the language of Sections 13 and 16, to which Mr. Forgan calls attention, and which relates to specific powers of Federal reserve banks, and also to an interpretation of Section 4, Sub-section 7th, of the Federal Reserve Act which deals with the general corporate powers of Federal reserve banks. That part of Section 13 which relates to this subject reads as follows:

"Any Federal reserve bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national bank notes, Federal reserve notes, or checks and drafts upon solvent member banks, payable upon presentation; or, solely for exchange purposes, may receive from other Federal reserve banks deposits of current funds in lawful money, national bank notes, or checks and drafts upon solvent member or other Federal reserve banks, payable upon presentation".

That part of Section 16 which relates to this subject matter reads as follows:

"Every Federal reserve bank shall receive on deposit at par from member banks or from Federal reserve banks checks and drafts drawn upon any of its depositors, and when remitted by a Federal reserve bank, checks and drafts drawn by any depositor in any other Federal reserve bank or member bank upon funds to the credit of said depositor in said reserve bank or member bank. Nothing herein contained shall be construed as prohibiting a member bank from charging its actual expense incurred in collecting and remitting funds, or for exchange sold to its patrons. The Federal Reserve Board shall, by rule, fix the charges to be collected by the member banks from its patrons whose checks are cleared through the Federal reserve bank and the charge which may be imposed for the service of clearing or collection rendered by the Federal reserve bank.

The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal reserve banks and their branches, and may at its discretion

exercise the functions of a clearing house for such Federal reserve banks, or may designate a Federal reserve bank to exercise such functions, and may also require each such bank to exercise the functions of a clearing house for its member banks."

Section 4, Sub-section 7th, in dealing with the general corporate powers of banks reads as follows:

"To exercise by its board of directors, or duly authorized officers or agents, all powers specifically granted by the provisions of this Act and such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this Act."

In passing upon the questions under consideration it is necessary to consider together the foregoing provisions of the Federal Reserve Act in determining (a) whether the power to receive such items on deposit is a power specifically granted by the Act, or (b) if not specifically granted, is the exercise of this power necessarily incident to any power which is specifically granted.

It needs no citation of authority to sustain the proposition that although not specifically granted, a power may be exercised which is necessarily incident to a power which is granted. This is not only the well recognized American rule relating to corporate powers but such rule is specifically recognized by Section 4, Sub-section 7th, above quoted.

Considering the question from the first standpoint, Section 13 provides that "any Federal reserve bank may receive from any of its member banks deposits of . . . checks and drafts upon solvent member banks . . . or, solely for exchange purposes, may receive from other Federal reserve banks deposits of . . . checks and drafts upon solvent member or other Federal reserve banks. . . ."

Section 16 provides that "Every Federal reserve bank shall receive on deposit . . . when remitted by a Federal reserve bank, checks and drafts drawn by any depositor in any other Federal reserve bank or member bank upon funds to the credit of said depositor in said reserve bank or member bank."

It will be observed from the foregoing that under Section 13 Federal reserve banks may receive from their own members checks and drafts upon solvent member banks. It is necessary, therefore, to determine the meaning of the language checks and drafts upon solvent member banks. Does this mean banks which are members of the same Federal reserve

bank as the depositing bank, or may a bank deposit in the Federal reserve bank of which it is a member checks or drafts drawn against banks which are solvent member banks of other Federal reserve banks?

The term "member bank" is defined by Section 1 as "any national bank, State bank, or bank or trust company which has become a member of one of the reserve banks created by this Act".

Attention is called to the fact that the bank which is authorized to make the deposit in a Federal reserve bank is designated as "any of its member banks" while in designating the bank against which items may be drawn this possessive pronoun is omitted and the language used is "checks and drafts upon solvent member banks". The omission of this qualification is doubly significant in the next clause where the statute provides that "solely for exchange purposes may receive from other Federal reserve banks.....checks and drafts upon solvent member or other Federal reserve banks".

In this latter case the statute not only fails to qualify which member banks such checks and drafts must be drawn against to be received but the context clearly shows that Federal reserve banks are expected to receive checks and drafts on banks which are members of other Federal reserve banks. For example, let us assume that the checks sent to the Federal reserve bank solely for exchange purposes by another Federal reserve bank are checks and drafts drawn against the receiving bank. It necessarily follows that the forwarding Federal reserve bank must have previously received such items from some source, that is to say, from one of its member banks, from the United States Government or from some other Federal reserve bank.

It would seem clear, therefore, that the language "checks and drafts upon solvent member banks" must be construed to mean checks and drafts drawn against banks which are members of any Federal reserve bank.

The same conclusion seems inevitable in Section 16 since a Federal reserve bank could not remit items drawn against depositors of other Federal reserve banks without first receiving such items from some source. If there should be any doubt as to this interpretation of the language "solvent member banks" and the conclusion should be reached that the power to receive checks and drafts on banks which are members of other Federal reserve banks is not specifically granted by statute, such a power must nevertheless be construed as a power incidental to those powers which are specifically granted for the reasons above stated.

The second question raised in the report referred to relates, as stated, to the right of a Federal Reserve bank to charge items sent it for collection against the account of a member bank without authority from such member bank. Mr. Forgan states that

"In the opinion of the Council it is unsound in principle and wrong in practice that a check drawn on a member bank should be charged to its reserve account with a Federal reserve bank without its authority and without its having had an opportunity to pass upon it".

I am not entirely clear upon just what theory a Federal reserve bank undertakes to charge up items drawn against other banks without authority from such bank. When a member bank makes a deposit in a Federal reserve bank to its reserve account, or to any other account, the relation of debtor and creditor is immediately established as between the Federal reserve bank and such member bank, and the credit balance thus created can legally be drawn against only by the depositing bank.

When any bank receives on deposit checks or drafts drawn against other banks, such items are accepted for collection as agent for the depositor and this agency continues until the items are actually collected.

It is true that in many instances the bank receiving such items on deposit immediately credits these items to the account of the depositor but where this is done it is credit extended upon the responsibility of the depositor and the bank reserves the right to charge back such items to the depositor's account if they are returned unpaid. Where the items are forwarded to correspondent banks for collection such banks in turn accept them as agents and the relation of debtor and creditor is not finally established until the check or draft is actually paid by the bank against which it is drawn. The decisions of our courts are uniform on this subject. Accordingly, where a Federal reserve bank in due course of business receives checks or drafts from any source for deposit or collection it acts merely as the agent for the depositor until such items are collected, and as such agent it has no right to appropriate funds held by it belonging to the bank against which such items are drawn for the payment of such items without specific authority from the bank in question. The depositing bank and not the bank against which such items are drawn is liable to the Federal reserve bank for any credit given to such depositing bank on the strength of such items, and the question of whether or not the depositing bank should be given credit immediately, or after the items are collected, is one for consideration by the Board.

Respectfully,

(Signed) H. C. ELLIOTT

Counsel

Hon. Charles S. Hamlin,

Governor.