Tentative Regulation_____
Series of 1915.

FEDERAL RESERVE BOARD.

Washington, April 26, 1915.

The Rediscount by Federal Reserve Banks or Purchase of Bills of Exchange in the Open Market.

The word "bill", when used in this regulation, shall be construed to include only bills of exchange, and the word "goods" shall be construed to include goods, wares, merchandise, or staple agricultural products, including live stock.

I.

Statutory Requirements.

The Federal Reserve Act provides that a bill, other than an acceptance, to be eligible for purchase by a Federal Reserve Bank, must comply with the following statutory requirements:

(a) It must have a maturity at the time of discount of not more than 90 days, except as provided by Regulation C, accompanying Circular No. 4, series of 1915, in regard to six months agricultural paper.

(b) It must have arisen out of actual commercial transactions; that is, be a bill which has been issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been or are to be used for such purposes.

(c) It must not have been issued for carrying or trading in stocks, bonds or other investment securities except bonds and notes of the Government of the United States; but the pledge of goods as security for a bill is not prohibited.

II.

Character of paper eligible.

The Federal Reserve Board, exercising its statutory right to define the character of a bill eligible for purchase by a Federal Reserve Bank, has determined:

(a) That it must be a bill representing the production or manufacture of certain definite articles or commodities, having a recognized standard of character and readily salable quality; the object being to have the paper represent salable and self liquidating transaction independent of the maker, acceptor or endorser of the note.

"There are, then, two primary kinds of bills in use in Europe - the one drawn by the producer, manufacturer, or trader on his respective purchaser and accepted by the latter, and the other, the bill drawn on and accepted by a bank or banker."

In circulars and regulations already promulgated, the purchase or discount of the second form of bill of exchange herein described has been provided for, and it therefore remains for us now to provide for the purchase of the first mentioned form of bill of exchange. This form is generally known to bankers as the "trade acceptance" in contradistinction to the "bankers' acceptance."

Section 13 of the Federal Reserve Act provides in part as follows:

"Upon the indorsement of any of its member banks, with a waiver of demand, notice and protest by such bank, any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act. Nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount; but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States. Notes, drafts and bills admitted to discount under the terms of this paragraph must have a maturity at the time of discount of not more than ninety days: Provided, That notes, drafts, and bills drawn or issued for agri-

cultural purposes or based on live stock and having a maturity not exceeding six months may be discounted in an amount to be limited to a percentage of the capital of the Federal reserve bank, to be ascertained and fixed by the Federal Reserve Board.

The aggregate of such 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 ten per centum 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 provides in part as follows:

"Any Federal Reserve Bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market at home or abroad, either from or to domestic or foreign banks, firms, corporations or indiciduals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the endorsement of a member bank."

The rediscount of bills of exchange referred to in the foregoing paragraphs has been provided for in Circular #3 and Regulation "B", series of 1915, which, as already stated, covers the rediscount not only of bills of exchange, but of notes and drafts as well. (i.e. these are all classed as forms of "commercial paper").

The rediscount of "bankers' acceptances" or their purchase in the open market have likewise been provided for in Circular No. 5 accompanied by Regulation "D".

The purchase of bills of exchange in the open market remains to be provided for. The language of the Act above quoted makes it evident that all bills of exchange which are eligible for rediscount are likewise eligible for purchase by Federal Reserve Banks, subject to regulations of this Board with or without the endorsement of a member bank, whether they are the acceptances of bankers or of merchants or manufacturers in good standing. Regulations which apply to the rediscount of bills of exchange (e.g., commercial paper) should consequently apply to the purchase of bills of exchange, except that the intervention of a member bank as the sole source through which such bills may be presented to a Federal Reserve Bank is eliminated, while the requirement that the indorsement of a member bank be placed upon such bills is likewise eliminated and such portions of the regulations relating to rediscount as grow out of the indorsement requirement may, therefore, be dispensed with. At the same time, it should be borne in mind that a bill of exchange in proper form, bearing the indorsement of a member bank, may be used as collateral for Federal Reserve Notes, while those not so indorsed can not be so used.

The accompanying regulation consequently follows the language of Regulation "B" attached to Circular #3, series of 1915, except in so far as departure is rendered necessary by the considerations set forth above.

It is not the conception of the Board that the above described bills of exchange or trade acceptances shall supplant or take the place of other approved forms of borrowing. It is most desirable that the manufacturer or producer shall make his own financial arrangements and borrow on the strength of his own credit and the statement which he is able to make, as provided in Circular No. 3, Regulation "B", and the above described bill of exchange simply supplements the former by introducing a form of two-name paper which is much used in Europe and was formerly much used in this country, as an alternative method. It should be safeguarded so as to represent the highest possible grade of domestic paper, supported not only by the good name of the maker of the bill, and the acceptor, (in some cases even by indorsement) but also by the value of readily salable commodities which it should represent.

(Signed) Charles S. Hamlin
Governor.

(Signed) H. Parker Willis
Secretary.