

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

WASHINGTON

April 30, 1915.

S I R :-

The question has been raised whether a Federal reserve bank may, under Section 13 of the Federal Reserve Act, discount acceptances endorsed by a member bank located in a district other than that of such reserve bank; and, if so, is the paper thus discounted eligible to be used as collateral security for Federal reserve notes issued under Section 16?

The Act provides that -

"Any Federal reserve bank may discount acceptances which are based on the importation or exportation of goods and which have a maturity at time of discount of not more than three months, and endorsed by at least one member bank."

It is to be noted that an acceptance to be eligible for discount under this provision of the Act must

- (1) be based on the importation or exportation of goods,
- (2) have a maturity at time of discount of not more than three months, and
- (3) be endorsed by at least one member bank.

The third requirement is the one to be specially considered in this connection. Does "member bank" mean a member of the particular Federal reserve bank, or does it import a more general significance and mean a bank which is a member of the Federal reserve system? If it is the latter, then no doubt any Federal reserve bank may discount acceptances for any member bank, irrespective of the district in which it is located.

Section 1 of the Federal Reserve Act states that -

"The term "member bank" shall be held to mean 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",

and, applying this definition to the section in question, it would seem clear that in considering the eligibility of acceptances for discount by a particular Federal reserve bank, it is immaterial in what district the endorsing member bank is located. As long as it

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is a member of some one Federal reserve bank, it is a "member bank" as defined by the Act itself.

This conclusion is further supported by the fact that Congress, in defining eligible paper other than acceptances, required specifically that the endorsement must be by "any of its member banks", thus expressly referring to the members of a certain Federal reserve bank. The fact that this restriction was omitted in fixing the qualities of eligible acceptances, indicates that Congress intended that there should be a broad market for this class of paper and that a Federal reserve bank should not be limited to acceptances endorsed by its own member banks,

This same construction of the term "member bank" has been accepted by the Board in relation to the power of a Federal reserve bank to receive deposits of "checks and drafts upon solvent member banks,"

Granting, therefore, that a Federal reserve bank may discount acceptances endorsed by a member bank of another district, may such paper be put up as collateral for Federal reserve notes?

It is clear that paper bought in the open market under the provisions of Section 14 is not eligible as collateral security unless it conforms to the provisions of Section 16, defining eligible collateral. That section provides in part that -

"The collateral security thus offered shall be notes and bills, accepted for rediscount under the provisions of Section 13 of this Act".

If, therefore, a Federal reserve bank receives acceptances for discount under the provisions of Section 13, in the manner indicated above, such paper may be used as collateral for Federal reserve notes. The sole requirement is that the collateral shall be notes and bills, - terms which are broad enough to include acceptances in this connection, - accepted for rediscount under the provisions of Section 13. The fact that the same paper may have been purchased in the open market, with or without the endorsement of a member bank, is immaterial if, in fact, the paper was accepted for discount under Section 13.

As previously indicated, acceptances endorsed by a member bank of another district may be so discounted, and if so,

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they may be put up as collateral security under the terms of Section 16, which define eligible collateral.

Respectfully,

(Signed) M. C. ELLIOTT,

Counsel.

To
Honorable C. S. Hamlin,
Governor, Federal Reserve Board.