FEDERAL RESERVE BOARD

WASHINGTON

May 18, 1915.

SUBJECT   Forward Discount Rates.

S i r   -

The question of the right of Federal Reserve
Banks to establish forward discount rates to cover ac-
ceptances or other eligible paper has been duly con-
sidered by this office, as requested.

In an opinion filed with the Board dated
November 19th, 1914, the question of the right of Fed-
eral reserve banks to establish discount rates, subject
to review by the Federal Reserve Board, was considered
at some length.

It is not deemed necessary to review in detail
the conclusions reached in this opinion but so far as
pertinent to the question now under consideration author-
ities were cited to show that Congress had the power to
delegate the right to fix discount rates to an adminis-
trative body and that this right has been vested in the
Federal reserve banks subject to review and determination
by the Federal Reserve Board.

The provisions of law which it is necessary to
consider in determining the question under consideration
are as follows

Section 14, sub-section (d), in defining one of
the powers of Federal reserve banks, provides as follows
"To establish from time to time, subject to re-
view and determination of the Federal Reserve Board,
rates of discount to be charged by the Federal re-
serve bank for each class of paper, which shall be
fixed with a view of accommodating commerce and bus-
iness".

Section 4 provides in part as follows
"Every Federal reserve bank shall be conducted
under the supervision and control of a board of di-
rectors   The board of directors shall perform the
duties usually appertaining to the office of di-
rectors of banking associations and all such duties
as are prescribed by law.   Said board shall admin-
ister the affairs of said bank fairly and impartially
and without discrimination in favor of or against
any member bank or banks, and shall, subject to the
provisions of law and the orders of the Federal Re-
serve Board, extend to each member bank such discounts,
advancements and accommodations as may be safely and
reasonably made with due regard for the claims and de-
mands of other member banks".

Analyzing these provisions, it appears that the
only limitations to which discount rates are subject are
as follows

(a) That they shall be fixed by the Federal reserve
     bank with the view of accommodating trade and
     commerce.

(b) That there shall be no discrimination as between
     member banks.

(c) That they shall be subject to review and deter-
     mination by the Federal Reserve Board.

Considering the question submitted in the light of
these restrictions, it appears -

(1) That the purpose of fixing a forward rate, that
     is, a rate to apply at some future date, is
     primarily to accommodate trade and commerce and
     to prevent those dealing in legitimate transac-
     tions from being subject to the speculative in-
     fluence of fluctuating rates. For example, a
     commercial transaction may be safely engaged in
     if the purchaser, or one who is assisting the pur-
     chaser to finance such a transaction, can have the
     assurance that an acceptance or other eligible pa-
     per possessing the necessary qualifications can be
     discounted or sold at a future date at a fixed
     rate, whereas if the rate is undetermined the ele-
     ment of speculation necessarily enters into the
     transaction.

(2)   If the rate is so fixed as to be equally applica-
      ble to all member banks, no element of discrimina-
      tion is involved.

(3)   If the Federal reserve bank fixes a rate at which
      it will discount or purchase various classes of
      paper at the present time and in so doing announces
      that the rate on any particular class of paper will
      not be increased beyond a fixed maximum for a
      specified number of days, and if the Board approves
      such rate, or if the maximum thus fixed by the
      Federal reserve bank is no greater than the maximum
      rate previously approved by the Board, it will
      have exercised its right of review and the rates
      will thereupon become definitely established in
      accordance with the provisions of law applicable
      thereto.

                            Respectfully,

                            M. C. ELLIOTT,

                                  Counsel.

Honorable Charles S. Hamlin,
Governor.