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FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS REPLY TO
 FEDERAL RESERVE BOARD

October 15, 1915.

Sir:

Under date of August 17 the Federal Reserve Board received a letter from Governor Strong of the Federal Reserve Bank of New York, inquiring whether a Federal reserve bank may undertake to perform the following services for its member banks:

- (1) Collect notes and drafts.
- (2) Collect items not covered by the present collection system
- (3) Collect items drawn on banks which are not members of the Federal reserve system.
- (4) Execute orders for securities.
- (5) Answer inquiries as to credits.
- (6) Purchase commercial paper.

These questions have had the careful attention of the Board, and it has been thought that the matters referred to were of such large interest as to warrant a general letter addressed to each agent. I have the honor, therefore, to advise you as follows:

First. There is no doubt whatever that a Federal reserve bank may collect notes and drafts sent to it by its member banks for collection and credit, such collection being a necessary incident to the power of a Federal reserve bank to receive deposits from a member bank.

Second. By items not covered by the present collection system, Mr. Strong evidently contemplates the collection of coupons,

etc., and the legal principles discussed under the first question will apply equally well to the collection of such other items. It seems, therefore, that the second question should be answered in the affirmative.

Third. The Board has already held that Federal reserve banks may collect items drawn on non-member banks, there being no difference whatever between the first question and this one as far as the legal rights are concerned. A Federal reserve bank could not, of course, accept checks drawn on non-member banks for immediate credit, because such non-member banks do not and can not legally have a deposit with the Federal reserve bank against which such items could be immediately charged; but there is no legal objection to the Federal reserve bank collecting such items from non-member banks and crediting them when collected to the account of the member bank for which the service was performed.

Fourth. There does not seem to be any provision of the Federal Reserve Act which gives to the Federal reserve banks either express or implied authority to execute orders for securities for member banks. It is true that a Federal reserve bank may, in an exceptional case where commercial paper also has the additional security of stocks and bonds, have to sell such stocks or bonds to realize on the security in case of default. But the right to sell securities on such an occasion as that does not imply a power to act as an agent for a member bank in the execution of general orders for

the purchase or sale of securities.

In connection with this matter the Board wishes, however, to suggest that it would be possible for Federal reserve banks acting on behalf of their members to transmit such orders to certain brokers, requesting such brokers to confirm their transactions direct to the member banks. It would not be improper for Federal reserve banks to give orders in their own name and to execute them on a commission basis. Federal reserve banks should not secure any revenue from such orders.

Fifth, There is no express provision in the Act relating to the answer of inquiries as to credits, but inasmuch as the regulations of the Federal Reserve Board reasonably contemplate that member banks maintain credit files and certify in each application for rediscount of paper by a Federal reserve bank that statements as to the credit of the borrowers are on file, it would seem clear that each Federal reserve bank might advise its member banks in advance as to the credit of various borrowers in its district. Such advice, however, must be considered merely as advice and not as a guaranty on the part of the Federal reserve bank. It must be carefully considered, however, that the Federal reserve banks receive from their members confidential reports which they may not divulge and that this may lead to embarrassment.

Sixth, While there is no express authority given in the Act permitting Federal reserve banks to act as agents for their member

banks in the purchase of commercial paper, nevertheless, there is no doubt that a Federal reserve bank might, under the provisions of Section 14, purchase bills of exchange of the kinds and maturities made eligible under Section 13, and sell such paper to one of its member banks under an agreement made prior to the transaction. There does not seem, however, to be any power vested in a Federal reserve bank which would permit of its buying promissory notes for its member banks. The only express authority given for the purchase of bills of exchange in such a manner is Section 14 which makes no mention of promissory notes.

The Board desires to emphasize in dealing with this question the fact that the task of advising and purchasing paper for member banks will involve a moral responsibility which must not be underestimated. Difficulties will arise: paper which has been bought with the greatest care and in the best possible faith will turn out to be bad, or it might happen that the bank examiner might criticize paper bought by the Federal reserve bank, or which has been bought upon the strength of information received from a Federal reserve bank. However, it may be possible to find a mode of accommodating the banks, and the object might be achieved by the banks simply acting as intermediaries in the matter, turning over the information as received from others to the member banks, and, when purchasing paper, forwarding the same with the letter of the broker through whom it has been purchased, the letter

being addressed direct to the purchasing member bank. Federal reserve banks should not endorse paper to their member banks, or turn over paper which they had previously bought. They should act distinctly only as intermediaries in the matter, without taking any responsibility or appearing as contractors.

The questions here raised might well be discussed at the conferences of Governors and Federal Reserve Agents, and the Board will be pleased to receive their reports and recommendations.

Respectfully,

Secretary.