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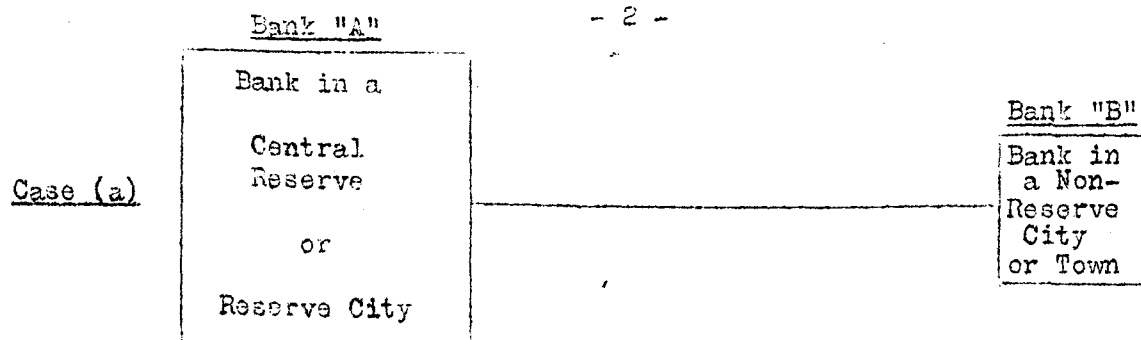
M E M O R A N D U M .

"If Bank "A" and Bank "B" have dealings with each other, and Bank "A" "receives on deposit" from one of its own depositors a check or draft drawn on Bank "B" and immediately credits the depositor's account with the amount, is there any recognized usage or custom of banking which would authorize Bank "A" to simultaneously debit the amount to the account of Bank "B"?"

Answer: "Yes" in some cases and "No" in others, depending on the relation of the banks to each other.

In considering this question the relations of one bank to another must be taken into account, for the answer will depend upon the exact arrangement which is a matter of contract or agreement between the banks and may be broadly differentiated under three heads, to wit:

- (a) Where Bank "A" is a large bank in a Reserve or Central Reserve City and Bank "B" a small bank which uses Bank "A" as its reserve depository,
- (b) Where Bank "A" is the little bank in the country and Bank "B" the large bank in the city, sending checks drawn against it for collection,
- (c) Where Banks "A" and "B" are on terms of equality, they may be banks in different cities, receiving each other's checks either on the basis of reciprocal balances, or on the collection basis, carrying no balances.

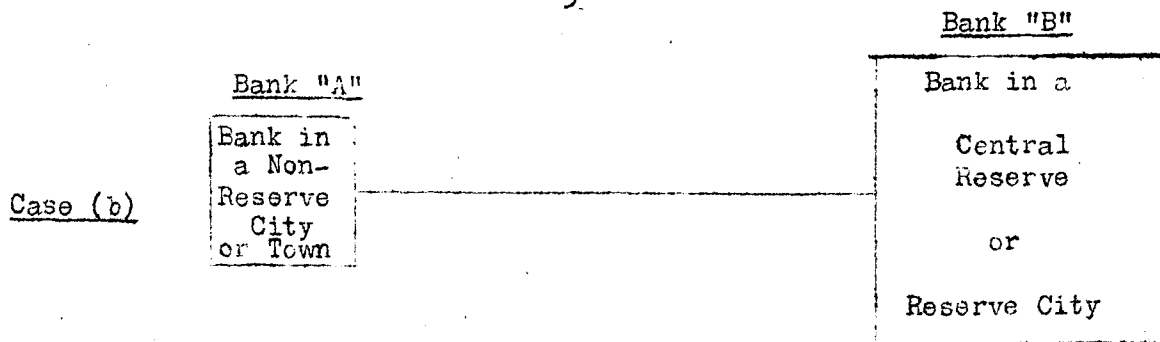
CASE (a)

Under the usual custom, which is of course subject to exceptions by agreement in particular cases, Bank "A" receives from its depositors, whether banks or individuals, checks drawn on Bank "B" which has a reserve account with it, and gives their depositors immediate credit. Bank "A" may receive such checks from some depositors, either bank or individuals as the case may be, at par, in consideration of a satisfactory balance carried with it by such depositor, and in other cases it may deduct a charge sufficient to compensate it for cost of collection and time involved in transit. If the depositor be a bank, the credit is usually a bookkeeping entry which does not draw interest or entitle the depositor bank to draw against it until the checks have actually been collected. As every credit must have a simultaneous corresponding debit, Bank "A" debits daily the sum total of the checks that it is sending to Bank "B" against an auxiliary account known as the "transit account", which debit in turn receives a corresponding credit after Bank "B" has received the checks and has made remittance to Bank "A" for them. If this remittance is in the form of a check on some other bank no debit is of course made against the account of Bank "B" with Bank "A", but where Bank "B" advises Bank "A" that it has credited Bank "A's" account with the amount of the checks, Bank "A" credits the transit account and charges the amount against Bank "B's" reserve account. In effect this is a system of immediate credit and deferred debit, but as between banks at least really tantamount to deferred credit and deferred debit since the immediate credit is not available. The principle governing this arrangement is that Bank "B" is carrying with Bank "A" a reserve account against which it has occasion to draw checks. Bank "B" desires to know at all times the exact amount that it has with Bank "A" subject to check, which would be impossible if it permitted Bank "A" to charge on receipt items against the account.

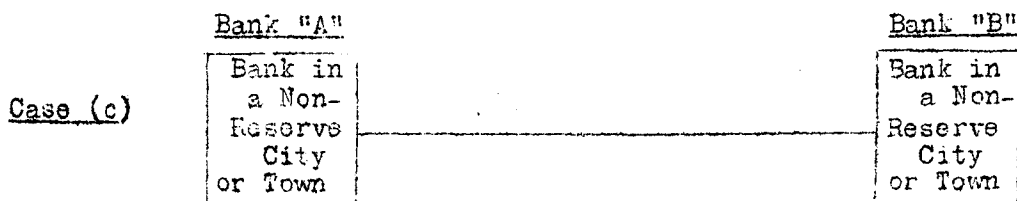
While, however, this is doubtless the predominating custom today, it is also true (1) that Bank "A" may have a general agreement with Bank "B" providing for immediate debit of items drawn on the latter, without getting any specific permission in any given case, such checks in some large banks amounting to a considerable percentage of the total, and (2) that Bank "A" may in some cases where it doubts the solvency or promptness of Bank "B" make immediate debit without getting permission to do so.

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CASE (b)

Under the usual rules, subject to exceptions, Bank "A" when it receives from its depositors checks drawn on Bank "B" or other banks, which by special arrangement it collects through Bank "B" gives the depositor immediate credit and at the same time makes an immediate debit on its own books against Bank "B". This operation enables Bank "A" to include the sum total of these items charged against Bank "B" as part of its lawful reserves. Bank "B" of course does not credit these items on the account of Bank "A" with it until these items have actually been received, and would not make such a credit against telegraphic advice from Bank "A" that it was mailing the items.

CASE (c)

In this case Banks "A" and "B" collect each others checks and checks on such other banks as may have been mutually agreed upon, on a reciprocal basis. Each bank charges the other with the sum total of the daily remittance letters and credits the other subject to final payment, with the sum total of items received from the other, making the entry upon receipt. Each account therefore, shows offsetting debits and credits and it frequently happens that balances are not large either way. As balances accumulate one way or the other, they are usually settled by check of the debtor bank upon its correspondent in a reserve city.

2/3/16

"Assuming that it were the statutory duty of each Federal Reserve Bank immediately to credit the accounts of its memberbanks with the face value of all checks and drafts drawn upon depositors of the Federal Reserve Bank which may be deposited with it by its member banks, could that duty be performed at all or could it be performed consistently with sound banking practice unless the Federal Reserve Bank could simultaneously debit the amounts of such checks and drafts to the accounts of the banks drawn upon?"

Answer: "No".

At the present time the common, but not universal rule of immediate credit and deferred debit results in the case of large banks with many correspondents carrying what is known as a "float" amounting, in at least one case which had come to our attention, to the large total of \$19,000,000. That is to say there are at any one time book credits aggregating that amount on the books of one bank in excess of the debits which have been charged by that bank against the individual bank corresponding with it. In other words, the banks in reserve or central reserve cities, to a considerable extent, carry these book credits in excess of the debits actually charged as an asset, under the title "Due from other banks." However, this is not quite so dangerous a procedure from the standpoint of the bank giving these credits as it would appear in the telling, for the reason that these credits are simply book credits, which banks are not permitted to draw against until collections have been made and the offsetting debits charged; and by the same token, interest is not allowed on these accounts until returns from collections have been completed.

The real effect of immediate credit and deferred debit is to make for the depositing banks a fictitious showing in reserve deposits in the hands of the correspondent bank in the reserve or central reserve city, for while the credits are not available to be drawn against, they are counted as book credits and hence as reserves.

2/3/16.