

MEMORANDUM

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Various Plans
for the
Clearing and Collection
of Checks.

Submitted to the
Federal Reserve Board.

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Washington, D.C.
March 21, 1916.

P L A N N O . 1 .

Plan of check collection and clearing recommended by a Committee of Federal Reserve Agents (Messrs. Martin, Curtiss and Jay) under date of October 13, 1915, and embodied in a report of the Committee, printed in full in the Federal Reserve Bulletin for November 1915, Pages 369-372.

1. That as soon as practicable, and under arrangements which will make clear and restrict its use to the purposes for which it was established, settlements through the gold settlement fund should be made daily.
2. That the Federal Reserve Banks should soon arrange to undertake the collection of notes and drafts, and of items drawn on non-member banks upon the most favorable terms which can be arranged in the respective districts.
3. That the Comptroller should be asked to endeavor to arrive at an agreement with all State bank supervisors that on and after a given date checks in the mail shall not be counted as reserve
4. That through mutual agreements, each Federal Reserve Bank should receive checks drawn on members of the collection system of every other Federal Reserve Bank, deferring credit for them a sufficient number of days to allow them to reach the Federal Reserve Bank of the district of origin, plus the number of days, if any, allowed by such Federal Reserve Bank to reach

the paying bank; and further

5. That through mutual agreement, any Federal Reserve Bank may receive for immediate credit checks drawn on members of the collection system of any other Federal Reserve Bank; and that whenever it is both practicable and more direct, member banks in such collection systems may send direct to the Federal Reserve Bank of the district of origin instead of to their own Federal Reserve Bank.
6. That the development of inter-district collecting need not await the completion of the intra-district collection systems.
7. That in extending the collection system both within and across district lines uniformity need not prevail but instead there should be freedom and flexibility of rules and requirements in order that each reserve bank may best meet the conditions and needs of its member banks.
8. That each Federal Reserve Bank should retain the right to change immediate credit points to deferred credit points, to assess upon members the cost of its collection service, to make charges against its member banks for using their balances to create exchange on other districts, and generally to make such rules and regulations as will enable it promptly to safeguard its position and protect itself against unsound development.

. P L A N N O 2

Plan for Check Collection Adopted by the Executive Committee of Governors at a meeting on October 23, 1915, submitting, with slight alterations a plan previously adopted by the Transit Managers of the Reserve Banks.

The Fifth Conference of Governors at the morning session, Saturday, October 23rd, 1915, considering the further development of the collection system, "adopted as its recommendation the substance of Vote 12, of the Transit Managers' Conference of October 6th and 7th, 1915, as representing substantially its views on this subject, and left to the Governors' Executive Committee the development of the details of the plan and its submission to the Federal Reserve Board with power to invite the attendance at any meetings of such of the transit men of the different banks as the committee may select."

In order that you may be advised of the principles adopted as the basis upon which the plan outlined in Vote 12, mentioned above was drafted, I enclose copies of the minutes of the Transit Managers' Conference with notations in ink showing such changes as were made by the Conference of Governors, except that a typewritten slip is attached giving the vote of the Governors Conference adopted in lieu of Vote 8 of the Transit Managers' Conference.

RECOMMENDATIONS TO EXECUTIVE COMMITTEE
BY THE TRANSIT MANAGERS

Morning, afternoon and night sessions were held on October 6th and 7th.

The deliberation of the Conference resulted in the passage of the votes recorded below, every representative being

present when each vote was taken, except that in one or two cases representatives absent for a few minutes authorized the Secretary to record their votes:

1. Voted - That we heartily favor every extension of the operation of a check collection system consistent with sound principles and permissible under the Federal Reserve Act.

Concurred in
by Governors

2. Voted - The deliberations of this body are based on the assumption that every member bank is required by law to cover at par all checks and drafts drawn upon it received from the Federal Reserve Bank of which said bank is a member. Immediate debit and credit not required.

Concurred in
by Governors

Mr. Pike of Atlanta asked to be reported as voting "No."

3. Voted - That the Federal Reserve Bank should have the privilege at its discretion of accepting checks on any bank, banker or trust company.

Concurred in
by Governors.

Unanimously carried.

4. Voted - We recommend that the actual expense of handling items on non-member banks shall be assessed by the Federal Reserve Bank against the member depositing such items with the Federal Reserve Bank.

Concurred in
by Governors.

Unanimously carried.

5. Voted - That consideration of a service charge by the Federal Reserve Banks for collection of checks on member banks deposited with the Federal Reserve Banks be deferred at this time.

Concurred in
by Governors

Carried without a dissenting voice

6. Voted - WHEREAS, Section 16 of the Federal Reserve Act stipulates that Federal Reserve Banks shall accept at par from their member banks checks and drafts on their members, this Conference recommends to the Governors' Conference that this provision of the Act be developed by the several Federal Reserve Banks on a deferred credit and deferred debit basis, but we believe that the privilege to handle items on an immediate debit and credit basis, so far as - expedient to do so, should be granted.

Carried.
 Mr. Pike voting "No", explaining that the Atlanta directors are on record as being opposed to putting into effect any system of clearing on a par basis.

7. Voted - That items sent to Federal Reserve Banks should not be counted as reserve until credited by the Federal Reserve Bank, but in computing reserves the total amount of such items may be deducted from the member banks' gross demand deposits.

Unanimously carried.

Concurred in
 by Governors.

8. Voted - That any plan for the interchange of checks between districts should apply only to those banks which do not impose restrictions as to endorsements.

Unanimously carried.

Substituted
 by Governors.

9. Voted - We recommend that the matter of transfers of funds for member banks between the several Federal Reserve Banks be handled on the basis outlined by the Governors of the Federal Reserve Banks at their recent Conference until such time as the intra-district

Concurred in
by Governors.

clearing facilities are developed to an extent which
will justify a reconsideration of this question.

Unanimously carried.

- 10. Voted - It is the sense of this meeting that transfers of funds between any two banks in any Federal Reserve District should be made by means of direct order rather than by checks and drafts.

Concurred in
by Governors.

Unanimously carried.

- 11. Voted - That the direct interchange of items between members by settlements through the Federal Reserve Banks be encouraged.

Concurred in
by Governors.

Unanimously carried.

- 12. Voted - We recommend to the Executive Committee of the Governors' Conference that a system of Inter-District Collection be inaugurated at once as follows:
Each Federal Reserve Bank will accept from any of its member banks for deferred credit and deferred debit at par, in accordance with the provisions of Section 16 of the Federal Reserve Act, checks and drafts on member banks in any of the other Federal Reserve Districts.
Each Federal Reserve Bank will agree to accept at par from other Federal Reserve Banks checks and drafts on its own members for credit a certain number of business days after the receipt of such checks and drafts, said number of days to be based upon the average length of time necessary to obtain returns from its members. Upon

receipt of advice from the other Federal Reserve Banks as to the number of days determined as aforesaid each Federal Reserve Bank will prepare a schedule of deferred credits applicable to checks on other Federal Reserve Districts deposited by its members.

Every Federal Reserve Bank operating on a deferred debit and deferred credit basis within the district will include in said schedule of deferred credits indication of the number of days for which it will defer credit to its members of checks and drafts on other members in its district.

Each Federal Reserve Bank will, if possible, avoid having more than three classes of deferred credit, and will request its member banks to sort items in accordance with the number of days for which credit is deferred, and to list in one letter all the items for which credit will be deferred the same number of days, furnishing the Federal Reserve Bank a separate letter for each class of deferred credit, as well as another letter in which will be listed all items to be accepted for immediate credit. Debit against a member bank's account of checks and drafts drawn upon it will be deferred for the same number of days for which credit is deferred in accepting such items from other members of the district.

Letters of transmittal to member banks will show plainly the date on which the items listed therein will be

charged to the member bank's account. Each letter of transmittal to a Federal Reserve Bank will show plainly the date on which credit is expected in accordance with the schedule of deferred credits, and will be charged to the Federal Reserve Bank on said date.

In order to guard against the great congestion incident to taking on at once a large increase in the volume of items, the plan should be developed in progressive stages by beginning with checks, each one of which amounts to \$1,000 or more, and gradually reducing the limits to the amount of each check until the limit can be safely removed. Changes in said limits should be identical in all districts both as to the amount and the date on which the change is made effective.

Nothing in the foregoing shall be construed as prohibiting any Federal Reserve Bank from continuing to handle such items as it is now receiving.

In order to show how schedules of deferred credit may be made up in each district, there is herewith submitted a tentative schedule applicable to checks deposited in the Federal Reserve Bank of Chicago by its members.

(See Exhibit "A")

In accepting checks from other Federal Reserve Banks, Chicago will give immediate credit for checks on members of the Chicago Clearing House Association, and

will defer for two days credit of checks and drafts on other banks in its district.

This plan contemplates that Federal Reserve Banks particularly may adopt short-cut methods for eliminating time in receiving credit.

For instance, if Chicago accumulated a large volume of items on Seattle, it would expect to send such items to Seattle for account of the Federal Reserve Bank of San Francisco, after agreeing with San Francisco as to a basis of deferred credit for our Seattle letter.

3/20/16.

EXHIBIT "A"SCHEDULE OF DEFERRED CREDITS FOR DISTRICT NO. 7.TWO DAYS.

Illinois (Except Chicago Clearing House Banks - immediate credit)

Indiana

Iowa

and all Federal Reserve Cities
except San Francisco.

Michigan

Wisconsin

FOUR DAYS.

Alabama

Maine

North Dakota

West Virginia

Arkansas

Maryland

Ohio

Colorado

Massachusetts

Oklahoma

Connecticut

Minnesota

Pennsylvania

Delaware

Mississippi

Rhode Island

District of
Columbia

Missouri

South Carolina and San Fran-
cisco, California.

Florida

Nebraska

South Dakota

Georgia

New Hampshire

Tennessee

Kansas

New Jersey

Texas

Kentucky

New York

Vermont

Louisiana

North Carolina

Virginia

EIGHT DAYS.

Arizona

Nevada

Washington

California (except San Francisco)

New Mexico

Wyoming

Idaho

Oregon

Montana

Utah

P L A N 3.A PLAN FOR CLEARING AND COLLECTING CHECKS
BY FEDERAL RESERVE BANKS.
(Suggested by Mr. W. S. Rowe of Cincinnati, Ohio)

Every Federal Reserve Bank would send a circular to its members stating that it proposed establishing a Clearing House Department (as required to do by the Federal Reserve Board, acting in accordance with the terms of the Act) for its members, accepting from its members and from any member bank in any other district, any item on member banks in its own district, and to charge for that service, a rate based both upon the volume in thousands and the actual number of items handled to cover its expenses, such rate to be determined by experience and then fixed by rule of the Federal Reserve Board.

On the other hand, the Federal Reserve Banks would state in the circular that they proposed paying each member bank for the service rendered by the member bank whose items sent to the Reserve Bank Clearing House had been offset against items on the member bank. This charge also would be determined by experience, to be based upon the volume in thousands, and would then be fixed by rule by the Federal Reserve Bank. These rulings as to charges would undoubtedly vary from time to time, depending upon conditions and seasons.

The circular would then recite that if any member bank proposed sending items on member banks, bearing the endorsement of a non-member bank, the service charge would be at a higher rate, as non-member banks either directly or indirectly, should not reap benefits at the same cost as the member banks. And further, any member bank, desiring the privilege of having checks of a neighboring non-member bank treated as though such checks were drawn upon it, might apply to, and this application might be granted by its Federal Reserve Bank. The rate of compensation to the member bank for clearing these items and the rate to be charged for collecting items on such non-member banks for whom arrangements as above had been made, would also be fixed by rule, but these rates would be higher than member bank check rates, thus operating as an additional reason why non-member banks should join the system, as ultimately it would cost a merchant more to collect items on non-member banks, than to collect items on member banks, and more to deposit items in a non-member bank than in a member bank, if this plan becomes operative in its fullest extent.

Under this plan, we for example, the First National Bank of Cincinnati, Ohio, would arrange to have checks drawn on a given list of non-member banks treated as though they were checks on ourselves, and after the Cleveland Bank had completed making such arrangements covering every non-member bank in the district, it would mail an announcement saying that it was prepared to accept through its clearing house department, any items on non-member banks, as well as any items on any of its own member banks, the

charges and payment to member banks to be determined later, as outlined above, and that it would credit or charge each member bank's account at the day's clearings, with the difference between the items sent through the clearing house, and the items received at the clearing house.

It is manifest that these operations of the clearing house department would not affect in any way, the total deposits of the Bank, as credits and debits would equal. In the banking department, however, a credit from the clearing house department might be immediately withdrawn, while a debit might even overdraw another account. To provide for this, rules in regard to maintaining a deposit in the Clearing House Department, to cover items to and from the Reserve Bank, should be promulgated, based upon fairness to the member banks and safety to the Reserve Banks. The proportionate relation between volume of items on and collected for a bank, to its required reserve, should affect the size of the clearing balance.

Inasmuch as similar notices would have now been sent out by the other 11 Banks, we would receive one from each of the other 11 Banks, stating that each Federal Reserve Bank would receive items in its Clearing House Department from any member bank or any bank in the district, and stating that each Federal Reserve Bank would take from any member bank outside of its district, any items on member banks or non-member banks, and that it would remit, after deducting a fair charge, to the send-

ing Bank's Reserve Bank for its credit. This remittance would then be credited to the account of the member bank by each Reserve Bank when received, subject to a slight charge, and as the settlement between the twelve Reserve Banks at the close of each day would be large, they might even be cleared as between themselves by telegraph each afternoon, and adjustments made through the main Clearing House of the twelve banks, at the office of the Federal Reserve Board, through the gold fund already created.

From a practical point of view, we would then write a letter to each of the twelve Reserve Banks, instead of writing as we do now, more than 500 letters, and would list items very much the way we do when sending items to Chicago, drawn on many different places. Chicago does not demand now that we sort our items based upon the places of payment, and we can see no reason why the Reserve Banks should, as they should be able to sort an immensely larger volume of items than the ones we would send, at a lower cost, and we would be paying our proportion of such cost.

Our endorsement on such items should read :

"Cleared through Federal Reserve Bank of _____"
followed by our name and the date sent, as well as the date it should be cleared unless letters are delayed in transit, and accordingly the actual date of clearing changed. No additional endorsement would be necessary. Our entry on our books would be

to charge each Reserve Bank with the total of our letter, and in figuring reserve, our balance at Cleveland would be counted, while the amount of the total letter sent to the other Banks would not be reserve. This other total, however, would undoubtedly not equal the total of our present balances in St. Louis, Chicago, New Orleans, New York, Albany, Boston, Baltimore, etc., even after allowing for such balances as we would wish to continue to keep in larger cities for exchange and other purposes.

If telegraphic remittance was arranged for with each of the other eleven banks, we could make the entry on our books covering letters sent today as follows: we could charge Cleveland with the total of the letters to Richmond, St. Louis and Chicago after one day; New York, Philadelphia, Boston, Kansas City, etc. on the second day, and finally San Francisco on the fifth day. Obviously the accumulation of such letters in transit before they reached their destination would not be very large.

Return items might be handled in two ways, either through the Reserve Bank which had previously cleared them, or direct to the member bank.

Experience would show which banks would be more usually creditors at the daily clearing, and which banks would more usually be debtors, and the rules suggested heretofore in regard to maintaining of balances on the books of each Reserve Bank could only be promulgated so as to be fair, after experience reached through a trial. Banks having customers apt to check unusually heavily should prepare themselves, and might well watch their larger ac-

counts; and such action would be in the interests of good banking.

This plan then contemplates, although many details are omitted or only inferred, the establishing in each Reserve Bank of the following departments:

- (I) Clearing House Department, in which all items on the district are cleared and in which department suitable and fair excess balances must be maintained.
- (II) Exchange Department, in which department the twelve Reserve Banks would clear as between themselves, and also clear the credit turned over from the resultant credit of a member of another district, whose checks on that district had been cleared in Department I.
- (III) Banking Department, in which only currency and drafts on itself would be accepted at par, and the resultant credit or debit after the days clearing in Department I would only be credited or charged to the member banks reserve account in this department, after deciding that the clearing balance in Department I was satisfactory. The Banking Department would also include the other functions of discount, examination, etc.

Thus the charges in Department I would be fairly large, based upon total in dollars and total number of items, and would also be reciprocal to cover expense incurred in restoring balances.

Charges in Department II would be smaller and charges in Department III would be nil, in so far as "cash items" are concerned. Of course, "collections" as distinguished from "cash items" could easily be handled upon a cost basis in either Department I or Department III.

3/20/16

PLAN NO. 4A COMPOSITE OF VARIOUS SUGGESTIONS FOR CHECK COLLECTION
AND CLEARING UNDER THE FEDERAL RESERVE ACT.

Predicated on the theory that the practical and perhaps the legal requirements demand that a check, being an order to pay cash at the counter of the Payee Bank, must be sent to the Payee Bank and be in the hands of that bank before it can be charged against it and credited to the Depositor.

1. Under Section 16 of the Federal Reserve Act, the Federal Reserve Board may require each Federal Reserve Bank to act as a Clearing House for checks drawn on banks of its District. In view of the further transfer of reserves on May 16th, the Board has set June 1, 1916, as the date when these functions shall be undertaken in a complete manner.
2. Every member bank handling many checks shall send in twelve separate envelopes, one to each Federal Reserve Bank, checks against banks of its respective district; provided, however, that a bank having less than, say fifty items for any given district may if it prefers send those items to its own Federal Reserve Bank for sorting and transmission.
3. Checks on banks in the same city clearing house district shall be given one day deferred credit and debit but all other checks in same district shall be given two days deferred credit and debit, unless the one-way time shall exceed that amount, in which case deferred credit and debit, equal to the one-way time, shall be fixed.

4. Checks on banks in other districts must be given a minimum deferred credit and debit of two days and an increment over this if, and by as much as the one-way time from the sending bank to the Federal Reserve Bank of the district on which check is drawn, plus the time from that Federal Reserve Bank to the payee bank, exceeds this two days.
5. Banks sending checks to Federal Reserve Banks of other districts shall claim credit for their own Federal Reserve Bank Exchange Account, sending duplicate of letter of transmittal to their own Federal Reserve Bank.
6. Nothing in the above shall prevent banks in neighboring cities sending checks direct to other banks provided that time is saved by so doing; thus Rochester, N. Y. and Buffalo, N. Y.; New Haven, Conn. and Hartford, Conn. might interchange checks on any mutually satisfactory basis if by doing so time is saved and float diminished.
7. The Federal Reserve Board will authorize Federal Reserve Banks to charge their own members as follows: $\frac{3}{4}\%$ per item plus 10¢ per thousand on all collections made for sending banks; at the same time, the Federal Reserve Board will authorize member banks to charge Federal Reserve Banks or other member banks, sending checks for collection, 10¢ per thousand upon all items sent. Settlements to be made monthly. These charges, subject to modification on sixty days notice, are intended to cover approximate average cost of remitting cash or exchange to meet balances or reserve requirements.

8. Member banks will be authorized to make collections of State bank items in their own town or within a convenient radius of operation and will be authorized to charge for this service the amounts above quoted or as much as the actual cost of the service should it exceed this amount - all such rates to be approved by the Federal Reserve Board.
9. Under the above arrangement every Federal Reserve Bank may be expected to receive direct from perhaps 3,000 banks bundles of checks drawn against its members. Those deposited by its own members are credited to the exchange account of the District represented by the depositing banks and debited against the drawee bank, according to the time schedule above referred to, while those sent from banks in other districts are credited to the exchange account of the Federal Reserve Bank of the district represented by the sending bank and debited simultaneously against the drawee bank.
10. A Federal Reserve Bank each night will have on its books amounts representing the aggregate of the above credited items, all of which have been charged against its own member banks, it will wire the amounts of these credits to the various Federal Reserve Banks and receive from these eleven Reserve Banks advice of the credits they have to its account. If as is assumed each Federal Reserve Bank keeps with every other Federal Reserve Bank an account for exchange purposes which may run a reasonable credit or debit either way, it is safe to say that in most cases the resulting debits and credits by these daily balances will only need to be settled once or twice a week through the Gold Settlement Fund.

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The above plan gives deferred credit and debit to the bank for all checks outside the home city starting with two days, but not beyond that in excess of the one-way time between districts, plus the one-way time from the Federal Reserve Bank of the drawee bank to that drawee bank. The time of transit is greatly shortened as compared with the methods commonly in vogue by reason of the direct routing and of using the twelve Federal Reserve Banks as clearing houses, each a focussing point for the checks of the district. Thus, the First National Bank of Columbus, Ohio, will send its Cleveland District checks to the Cleveland Reserve Bank for deposit, claiming immediate credit two days later, at the same time it sends Chicago District checks to the Chicago Reserve Bank, St. Louis District checks to the St. Louis Reserve Bank, etc. These checks reaching these Federal Reserve Banks the next day sent to the drawee banks and in most cases are charged the following day against the accounts of the drawee bank and credited to the exchange account of the Federal Reserve Bank of Cleveland. Thus the First National Bank of Columbus will claim two days deferred credit for Cleveland items and, in most cases, two days deferred credit for items drawn on banks in the Chicago, St. Louis, Atlanta and Richmond Districts, and proportionately later datings for more distant Districts. It is safe to say that a very large proportion of the business of the country in check clearing would be done on a two days deferred basis.

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The obvious advantage of this method is the direct and simple routing of all items and the consequent reduction of float. Whereas large city banks are now required to send checks for collection to some 500 points, under this plan, they would

be enabled to send checks to twelve centers, and perhaps five or six other points with which the interchange of checks is considerable. Generally speaking, the clearing and collecting of checks is by this plan focussed and concentrated at twelve Federal Reserve Banks with a minimum of delay. At the same time small country banks would be given the privilege of sending all their checks regardless of the district on which drawn to their Federal Reserve Banks, or to some correspondent bank for collection and credit.

13. The reason it is not necessary to defer debit and credit beyond the one-way time may be thus illustrated: Let us suppose, for the sake of an argument, that the Federal Reserve Bank of Chicago sends to its Agent at Des Moines all the items drawn against Des Moines Banks. That agent presents the checks next morning at the various banks and draws out cash, or takes a credit on the local bank's books. Having thus accumulated in the five local banks, say \$250,000 in cash or credits, he wires or telephones the Federal Reserve Bank of Chicago of the fact. The Federal Reserve Bank of Chicago replies that it has itself received in checks sent by Des Moines banks against Chicago banks items aggregating \$260,000 and that it is, therefore, not necessary for the Des Moines agent to remit any cash or exchange, because the drawings on Des Moines are more than offset by the drawings on Chicago; in fact that Chicago must send Des Moines \$10,000 as a balance. However, as the amount is small and the balance may

may be reversed the next day, it is agreed between the agent and principal that the balance in favor of Des Moines shall be allowed to stand. It will thus be seen that this plan of credit and debit deferred to equal the one-way time admits the principle that the payee bank shall see items drawn against it before having these items charged against its reserves and enables it, if any of these items are unusually large, to make a special arrangement by wire or telephone to meet them.

3/20/16

P L A N N O . 5 .

Memorandum and Plan submitted by the Governor of the Federal Reserve Bank of Dallas, Texas, under date of March 15, 1916, for the Clearing of Checks under what may be designated as the Talley System of Offsets.

After careful consideration of all suggested or proposed plans for a clearing or collection system which have come to our notice, the officers of the Federal Reserve Bank of Dallas are firmly convinced that none can ever be adopted which will be acceptable to the member banks or satisfactory to the Federal Reserve Banks unless it be based upon a system of offsets, or what is known as the clearing principle in use by all of the local clearing houses of this country.

The Cashier of the Federal Reserve Bank of Dallas, Mr. Lynn P. Talley, has made a thorough study of the details of such a plan and an outline of the fundamental details of the result of his study is presented below. This plan is not to be confused with the plan of operation in use by the Boston Country Clearing House and other similar Country Clearing Houses which are nothing more nor less than Joint Collection Agencies.

Some of its advantages are as follows:

(1) An immediate debit and credit system would of necessity, frequently impair and destroy reserves and place upon the Federal Reserve Banks such a burden of "float" that their usefulness would be seriously impaired. On the other hand a deferred debit and credit system would place upon the member banks the entire burden

of "float", without offset, on which account it would be used only to a very limited extent. The plan proposed is, in effect, an immediate debit and credit system to the extent of the amount of offsets, with a minimized deferred debit and credit of only the amount of the resultant balances, which deferred debit and credit is equitably distributed.

(2) This plan provides for the payment of items by the drawee bank only at its counter and after it has inspected the items.

(3) The reserve balances of a member bank with the Federal Reserve Bank are debited only at the direction of said member bank, which therefore has knowledge at all times of the condition of its reserve.

(4) The cost is minimized and is equitably distributed among the banks receiving the benefit of the transfers of funds necessary to complete the settlement.

(5) The plan of apportioning returns to the creditor banks in the order of their size (Section 2 (e)) is based upon the axiomatic principle that one day's interest on \$10,000. is equal to five days' interest on \$2,000., and is the most equitable manner of facilitating settlements.

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We were so sure of the practicability of this plan that on Monday, December 27, 1915, we inaugurated, in the Federal Reserve Bank of Dallas, a "Reserve City Clearing House", made up of the thirty-three member banks in the six reserve cities of this district, which has proved the success of the plan and has been so satisfactory to the participating banks that it is still in operation and will be

continued until superseded by some plan promulgated by the Federal Reserve Board.

The total amount of items cleared through this Reserve City Clearing House from December 27, 1915, to March 15, 1916, was \$85,637,602.94, with resultant balances amounting to \$20,974,418.42. Of this amount of balances \$5,874,900. of the debits were settled through deposits of Eastern Exchange; \$3,108,000. by deposits of currency; \$7,088,518.42, by instructed debits against reserve balances in this bank; while \$1,903,000. was settled by arrangements between debtor and creditor banks in the same city.

We believe that a careful study of the following outline will convince any one of the practicability and simplicity of the plan.

OUTLINE OF FUNDAMENTAL PRINCIPLES
OF THE TALLEY PLAN OF CLEARINGS

The plan proposed contemplates a Federal Reserve District Clearing House, and each Federal Reserve Bank, in handling clearing items for its members through its Clearing House Department shall act as agent only and shall not become responsible in any manner whatever for delinquency or default of any member.

It is proposed that each Federal Reserve Bank shall inaugurate a Clearing House Department along the following lines:

- (1) The Clearing House Department shall clear for the member banks of its district checks and drafts drawn upon any other member bank of the same district except such

as are drawn by or endorsed by banks which are not members of the Federal Reserve System.

(2) The total of items received from a member bank shall be credited to such member on the credit side of the Clearing House balance sheet.

The total of items received against a member shall be debited to such member on the debit side of the Clearing House balance sheet.

Resultant balances between "Items received" and "Items sent" from and to a member bank will be settled from each day's settlement sheet in the following manner:

(a) All items received through the Clearing House on a given member will be forwarded immediately to said member, properly listed and totaled, which list shall be made in duplicate and shall show from whom received. The duplicate list shall be a part of the Clearing House records.

(b) The Clearing House shall forward to each member interested in the day's clearings a slip showing total of items received from that member, total of items sent to that member, and the resultant credit or debit balance due to or from that member.

(c) The Clearing House shall prepare and send to each member receiving a debit balance in the day's clearings a settlement check for the amount of such debit balance, which check shall be drawn against the reserve balance of such member in the Federal Reserve Bank and shall be payable to the District Clearing House.

(d) This check shall be immediately signed by the

proper officer of the member bank and returned to the Clearing House to be apportioned among the creditor banks. If the payment of this settlement check would reduce the reserve account of the member bank below the required amount, it shall be the bounden duty of such member bank to accompany said settlement check with a deposit of acceptable funds sufficient in amount to make good the required reserve.

(e) The amount of the first settlement checks received from debtor banks shall be apportioned to the bank receiving the largest credit balance in the clearings of that day, then to the second largest, and so on down, each creditor bank receiving credit in its reserve account for its credit balance as soon as settlement checks sufficient in amount have been received and paid by the Federal Reserve Bank.

(f) Clearings shall be made on each business day, and neither debit nor credit balances may become cumulative, but each day's clearings must be settled separately.

(g) Advices of all debit balances amounting to twenty-five thousand dollars (\$25,000) and over will be telegraphed to the owing bank.

(h) When, in order to meet its settlement check only, it becomes necessary for a debtor bank to ship currency to the Clearing House, said debtor bank shall be entitled to and receive the actual minimum cost of transportation from its office to the Federal Reserve Bank of such currency actually shipped, providing advice of such cost accompanies the settlement check. Such cost

shall be credited to the reserve account of the shipping member and shall be proportionately charged to the reserve accounts of all members clearing items on the shipping member on that day.

(i) Debtor banks, in order to prepare their reserve accounts to meet their settlement checks, may make remittances in New York, Chicago or St. Louis exchange at the rate promulgated by the Federal Reserve Bank for such exchange.

(j) Settlement checks must be signed and returned to the District Clearing House on the same day they are received by the debtor bank.

(k) In the event a member bank receiving a debit balance in the District Clearing House fails to pay such debit balance promptly, or fails to provide funds in its reserve account with the Federal Reserve Bank to meet its Clearing House settlement checks, or suspends payment and is placed in the hands of a receiver, or otherwise becomes unable to meet its obligations on demand, or is otherwise insolvent, then the Federal Reserve Bank shall proceed as follows:

The amount of all items on such defaulting bank, which are in the process of collection or have been sent to such drawee or defaulting bank and for which payment has not been received by the District Clearing House, shall be credited to the District Clearing House, and the amount of each item included in such credit shall be charged to the reserve account of the member bank endorsing said item to the District Clearing House Department.

(3) Member banks may, if preferred, send their items to any other member bank situated in the prevailing direction such items

would take in their natural course of collection, and items so sent may then, in turn, be sent to the District Clearing House Department of the Federal Reserve Bank, but in no case will the Federal Reserve Bank receive in its Clearing House Department items bearing the endorsement of more than two member banks.

(4) Unpaid items received from the Clearing House shall be returned direct by the drawee bank to the bank endorsing same to the District Clearing House, and a debit ticket for the amount shall be cleared on such endorser through the Clearing House, carbon duplicate of such debit ticket being attached to the returned unpaid items. These tickets will be in certificate form and may become a part or all of the remittance to the Federal Reserve Bank to cover a Clearing House debit

(5) A slip giving the name of the sending bank and directing wire advice of non-payment must be attached to each item of \$1,000 or over at the time it is sent to the Clearing House Department, which instructions must be followed by the drawee bank.

(6) All items of over ten dollars (\$10) must be sent subject to protest if not paid.

(7) The expense of maintenance and operation of the District Clearing House Department shall be borne by the member banks by paying, on the first of each month, two cents for each item cleared during the preceding month until it is determined by experience what is the actual cost per item. When this has been determined such actual cost shall be paid

(8) The plan shall be promulgated by the Federal Reserve

Board and shall be mandatory under the provisions of Section 16 of the Federal Reserve Act.

(9) Such general rules and modifications of rules as may be necessary in the operation of the plan may be promulgated by the Federal Reserve Board from time to time

3/20/16.

SUPPLEMENTAL TO PLAN NO. 5 SUBMITTED
BY MR. LYNN P. TALLEY, CASHIER OF FEDERAL RE-
SERVE BANK OF DALLAS.

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The fundamental principles upon which any clearing plan which might be adopted must be based :

First. That the face of a check and the back of a check are entirely different propositions. Granting that a check is payable at the counter of the drawee bank and that it is not incumbent upon the drawee bank to transport the funds to the point where the holder resides, at an expense to the payer. The holder of a check at a point different from the place of payment receives the check for value and determines its value at the time the check is received and it is then incumbent upon him, either with or without previous knowledge of conditions, to convert the check into funds that he can use.

Second. That the interchange of items between banks under present methods perhaps increases the float two or three fold. Briefly, because a bank concentrates its items with various other banks of its own selection and the receiving bank must, of course, stand the burden of float in conversion. A large proportion of these checks received must be collected by sending them to banks which will send the last endorser a remittance drawn on still another bank, perhaps in another city, with which it concentrates its items for balances through its own choice. There is then a float created in collecting returns which have been sent in for original items.

Third. That this choice of correspondents is largely a matter of individual right and need not be necessarily disturbed by breaking off relations of years standing by being compelled to collect miscellaneous items through the Federal Reserve Bank.

Therefore, the plan provides that a member bank may send its items to another member bank which may, in turn, deposit them with the Federal Reserve Bank for credit in the District Clearing House, provided such items bear no more than two member banks' endorsements, including its own, and the prevailing direction of collection which the item would naturally take is not violated.

You can readily see that this would permit the country banks to continue to send their items to city banks which would have facilities available for collecting them through the Federal Reserve Bank.

Fourth. To minimize the float referred to in (1st) by the system of offset under the clearing principles; that is to say, the float would be reduced to collecting the difference between items sent and received at the District Clearing House, which I venture to say would be somewhere in the neighborhood of 20 to 25% of the total volume cleared. In addition there would be a float equal to the transit time between the location of the member bank and the Federal Reserve Bank, which would be equitably distributed between the member banks and involve only their own items. This float, however, could be appreciably reduced by member banks sending items received in volume on any one point direct to the urawee member banks at that point and sending us a copy of the letter.

Fifth. Exchange charges have not been taken into consideration in the revised plan submitted in view of the clear intent of the Act to abolish exchange charges to the point of only actual expense involved in the transportation of funds. Since, technically, exchange charges are based on shipments of the actual amount of currency representing the difference in the balance of trade, the cost, under the plan proposed, would be reduced to a final minimum as remittance would involve the settlement of only the difference between items sent and received.

You can see, therefore, that I have sought to reconcile conditions existing heretofore with the new order of things to the extent that I believe the plan fairly overcomes the objection of the member banks in giving up their exchange charges by providing them with the most economical facilities at the Federal Reserve Bank for the collection of items rather than issuing a mandate that member banks must clear their items through Federal Reserve Banks.

Sixth. It is very natural that any plan suggested would emanate from some large Reserve or Central Reserve city institutions by reason of its wide experience in receiving and collecting miscellaneous items or by suggestion of one who had had broad experience along this line in these larger institutions.

3/21/16

PLAN NO. 6.A PLAN FOR CHECK COLLECTIONS BY FEDERAL RESERVE BANKS.

(Submitted by Mr. Ray M. Gidney of the Staff
of the Federal Reserve Board)

Preliminary Statement

In the consideration by those connected with the Federal Reserve Banks of the problems connected with the establishment of check collection service by Federal Reserve Banks, there has been substantial agreement that the greatest difficulty to be met is that involved in carrying "float" represented by checks in process of collection, which might have to be assumed by the Federal Reserve Banks. "Float" in this sense may be defined as the extension of credit which takes place when credit is given for a check in advance of its actual payment by the bank upon which it is drawn. Its magnitude is measured by the amount of checks in transit at any one time, and the "float" for a single item is its amount multiplied by the number of days which must elapse before it is collected.

The question of who should carry the "float" must be considered and dealt with before any plan of check collection can safely be put in operation. Three parties may be recognized in this transaction; the payer of the check, the payee, and the agency through which the payee attempts to collect the item. The payer is represented by the bank upon which the check is drawn, the payee by the bank which receives the check on deposit in first instance, and the collecting agency by the bank which is used as an intermediary in the collection of the check, in the present situation the Federal Reserve Bank. One of these parties must carry the float. The

general practice now is that parties receiving the check in first instance carry the float. A firm or individual receiving a check and depositing it in a bank is required to keep a balance which will justify the bank in handling and collecting the check, and as a rule is not allowed to withdraw the funds in advance of collection by the bank. The bank which thus receives an out of town check must in turn carry the "float" whether it sends the check direct to the paying bank or sends it through a collecting bank. In the first case it is not permitted to charge the bank upon which the check is drawn until the latter has received the check and given authority for the charge. Even if the check is collected through such an institution as the Boston Country Clearing House, the bank does not get its money until two days have elapsed. If the bank attempts to collect the check through another bank it does not receive real credit until the check is collected, although it gets an immediate credit in appearance, but must keep a "reasonable" minimum balance on deposit with the correspondent and must not draw against items until they are collected.

The Executive Committee of the Conference of Governors has recommended that a Federal Reserve Bank, if it is to act as a collecting agent for its member banks, shall not carry the float. The reasons urged are that to the extent that a Reserve Bank does so, it impairs its power to meet the requirements of its members for rediscount facilities, and that the amount of the aggregate float of the country is so large as to absorb almost the entire loaning power of the Federal Reserve Banks. The Governors also point out

the difficulties to be encountered if it is sought to have the paying banks carry the burden. Member banks upon which checks are handled are required to maintain excess reserves equal to the amount of checks in transit to them from the Federal Reserve Bank during two or more days' business; they have no very exact means of estimating the amount of checks which are thus in transit and overdrafts are likely to occur with possibility of loss to the Federal Reserve Bank. The Governors do not, however, except in connection with their proposed plan for deferred debit and deferred credit, appear to consider the possibility of leaving the burden of carrying the float where it is; namely with the bank which has received a check on deposit in first instance and therefore has it to collect as best it can.

If a method can be found whereby the Federal Reserve Banks can successfully perform the check collection functions clearly contemplated by the Federal Reserve Act, without carrying the float involved, it is obvious that they should not carry the said float. There is doubt as to whether they are able to assume the burden of the float without seriously impairing their loaning power and even if they are able to do so they should not grant the credit extension involved without proper remuneration. They are corporations dealing in credit and should not give away in any form the goods which it is their business to sell. At the same time it should not be the problem of the Federal Reserve Banks to determine whether the float shall be borne by the banks upon which checks are drawn or by the banks which have received the checks upon deposit. This is

a matter of general business arrangement with which the Federal Reserve Banks are not directly concerned. The purposes of the Act will be carried out and the usefulness of the Federal Reserve Banks greatly increased if they are able to provide prompt collection at par of checks drawn on member banks and prompt collection, with a moderate exchange charge of checks drawn on non-member banks in cities where there are also member banks. To this end the following plan, combining features of both the immediate credit and debit and the deferred credit and debit plans, and based upon the assumption that member banks can be required to remit promptly at par for checks on themselves sent to them by the Federal Reserve Banks, is submitted:

Details of Proposed Plan.

Each member bank will carry 'clearings account' in the books of its Federal Reserve Bank, in addition to its reserve account. All deposits of checks drawn on member banks will be credited to the depositing banks in their clearings accounts and charged to the member banks upon which the checks are drawn, in their clearings accounts. The depositing banks will be permitted to draw against the balances resulting from deposits of checks on other member banks only after a suitable time has elapsed to permit collection or offset of the items. The length of time which it will be necessary to delay such withdrawals will vary in the different districts, reaching a maximum in the San Francisco District, and can be finally determined only after some months of experience in the operation of the plan. To start with sufficient time should be allowed for the checks to reach the paying banks and a remittance in payment to be received in

return. The immediate result of this operation will be that the depositing banks will have credit balances and the paying banks overdraft balances, and as the overdraft balances will just offset the credit balances, it will not be necessary to maintain a reserve against the latter. In the case of a district in which practically all banking points can be reached by mail in one day the banks which acquire credit balances will be permitted to withdraw any portion of such balances representing deposits made two days or more previously. In this way, even assuming that the paying banks have not themselves made deposits of checks on other member banks and thus become creditors as well as debtors, they will remit funds in time to meet the withdrawals permitted so that overdraft accounts will not exceed the credit balance accounts.

If, however, the banks which we have been considering as the paying banks are constantly mailing checks to the Federal Reserve Bank for deposit, their remittances will arrive in such manner as to offset the checks against them and thus reduce the time of float by one-half. To what extent this will occur can of course only be determined from the actual operations of the clearings system, but it is certain that the offset principle will be operative to a very large extent as operations become general. Through this reduction in the time of float the average time which must elapse before a member bank can draw on a deposit will be proportionately shortened. This matter of offset is of greatest importance and in it lies the superiority of the plan which is given here over the plan under which the Boston Country Clearing House is now operating and over the plan

of deferred credit and deferred debit proposed by the Governors of the Federal Reserve Banks. It is much as though the New England Country Banks instead of awaiting receipt of their checks from the Boston Country Clearing House and then drawing a draft on a Boston correspondent bank in favor of the Clearing House for the amount of the remittance, were to send daily to the clearing house all checks on Boston which they might receive in the course of business instead of sending them to Boston correspondents against whom they later issue a draft in payment for the checks received through the clearing house. It is clear that if this were done the effect would be to shorten by one-half time required for the collection of checks sent out by the Boston Country Clearing House.

The following example will illustrate the operation of offset, the first column showing a case in which offset is effective and the second column a case where it does not operate and in which, as with the Boston Country Clearing House and the Governors' plan of deferred credit and debit, a return remittance must be awaited.

A member bank in Philadelphia deposits with the Federal Reserve Bank of Philadelphia on a certain day for credit in its clearings account, checks aggregating \$25,000 on a member bank in Harrisburg, Pa. The following will be the course of the transaction:

With offset.

On the same day the Harrisburg member bank mails to the Federal Reserve Bank of Philadelphia for deposit in its clearings account, checks on the Philadelphia member bank amounting to \$25,000.00. Entries will be as follows:

Day of remittance:

Philadelphia member bank charges Federal Reserve Bank of Philadelphia, \$25,000.

Federal Reserve Bank of Philadelphia credits Philadelphia member bank, \$25,000.

Federal Reserve Bank of Philadelphia charges Harrisburg member bank \$25,000

Harrisburg member bank charges Federal Reserve Bank of Philadelphia \$25,000.

Without offset.

On the following day and upon receipt of the remittance the Harrisburg member bank issues and forwards to the Federal Reserve Bank of Philadelphia, its draft on the Philadelphia member bank, for \$25,000.00. Entries will be as follows:

Day of remittance:

Philadelphia member bank charges Federal Reserve Bank of Philadelphia \$25,000.

Federal Reserve Bank, Philadelphia credits Philadelphia member bank, \$25,000.

Federal Reserve Bank of Phila. charges Harrisburg member bank \$25,000.

First day following:

Harrisburg member bank receives remittance from Federal Reserve Bank and credits account of the latter \$25,000.

Federal Reserve Bank receives remittance from the Harrisburg member bank and credits account of the latter, \$25,000.

Federal Reserve Bank charges Philadelphia member bank \$25,000 and delivers by messenger the drafts, etc., received from the Harrisburg member bank.

Philadelphia member bank credits Federal Reserve Bank \$25,000 for items thus received.

Transaction closed.

First day following:

Harrisburg member bank receives remittance from Federal Reserve Bank and sends in return draft on Philadelphia member bank \$25,000.

Collection example, continued.

Without offset.

Second day following:

Federal Reserve Bank of Philadelphia receives remittance from Harrisburg member bank and credits account of the latter, \$25,000.

Federal Reserve Bank charges Phila. member bank \$25,000 and delivers by messenger the draft received from the Harrisburg member bank.

Philadelphia member bank credits Federal Reserve Bank \$25,000 for draft thus received.

Transaction closed.

Reserve status of clearings accounts.

Such portion of the balance of each member bank in its clearings account as is available for withdrawal may be counted as reserve, for it can at any time be withdrawn or transferred to the regular reserve account, but such portion as is not available for withdrawal should not be so counted as it represents uncollected items. Neither should the Federal Reserve Bank be required to hold reserve against the portion of the clearings accounts representing uncollected items, but it should be required to hold reserve against that portion which represents items which have been collected and are therefore subject to withdrawal at any time.

It will be objected by some that the credit given to member banks which deposit items in the clearings account will not be "immediate credit". This is true, but the credit given is certain to be more nearly immediate than would be given under the deferred debit and credit plan proposed by the Governors, which does not contemplate offset of

of items but apparently treats each remittance as a unit to be settled for separately. It will also be more nearly "immediate credit" than is given to banks which collect through the Boston Country Clearing House and than that given by check collecting banks which do not permit withdrawals until the item is collected and which do not utilize the practice of offsetting items. It would be well to provide that the credit may be made immediate in fact as well as in name by permitting a member bank which wishes to withdraw a balance created by deposit of items on other member banks or to count such balance as reserve, before the items have been collected or offset, to do so by paying interest thereon at the rate in force for discount of short-term paper. In such case the Federal Reserve Bank would assume float to the amount involved but would be properly reimbursed for so doing.

Prompt remittances at par are essential to the successful operation of this plan. Where a bank does not remit promptly an interest charge at the rate current for short-term paper should be assessed against it for the time of such withholding on the amount of items upon which prompt remittance is withheld.

Checks on non-member banks.

It is quite generally agreed that checks on non-member banks must be handled by the Federal Reserve Banks in order to make the check collection system completely successful. This step should be taken at once in connection with the plan here submitted and with the cooperation

of member banks. Arrangements can doubtless be entered into with most member banks under which they will handle checks on non-member banks in their respective cities and towns at a charge of five or ten cents per hundred dollars, such charge to be computed on the total amount of such checks sent in a remittance letter. Checks on non-member banks in cities where there are also member banks, may then be received by the Federal Reserve Banks just as checks on member banks will be, but subject to a collection charge of five or ten cents per hundred dollars. This plan will doubtless prove sufficiently remunerative to the member banks handling the checks and will result in many State banks entering the system. The facilities which the Federal Reserve Banks will thus be able to offer will greatly exceed those offered by any country clearing house.

Inter-district clearings.

Inter-district clearings should be undertaken very soon after the inauguration of the plan herein outlined. Checks and drafts on member banks in other Federal Reserve Districts should be taken on the basis of the transit time between the Federal Reserve Cities plus the average transit time between the Federal Reserve Bank of the paying district and the member banks upon whom the checks are drawn. Drafts on Federal Reserve Banks should be credited immediately at par. This may appear to be a disregard of the problem of float, but when it is considered that each Federal Reserve Bank has a heavy deposit in the Gold Settlement Fund and that the acquisition by one Federal Reserve Bank of a draft on another Federal Reserve Bank gives control of a

corresponding portion of the Gold Settlement Fund, it is apparent that drafts should be regarded as cash by all Federal Reserve Banks. In order to make this as apparent as possible daily settlements should be at once adopted on the basis suggested in the report of the Preliminary Organization Committee and more lately by Mr. W. E. Cadwallader. The effect of making such drafts acceptable for immediate ^{credit}/at par by all Federal Reserve Banks will be to give them currency and make them the preferred form of remittance within the United States. This will of course be of advantage to the Federal Reserve Banks in many ways, one of which will be that there will at all times be a large credit float in the form of drafts outstanding on Federal Reserve Banks, which will be more than sufficient to offset any possible burden of float which might fall upon the Federal Reserve Banks by reason of cashing or crediting immediately drafts drawn on each other. The amount of such drafts in transit from the drawing banks and not yet presented to a Federal Reserve Bank would be always greater than the amount in transit between the Federal Reserve Banks for the reason that the time of such float would be at most the mailing time between the Federal Reserve Cities concerned and would be further shortened by offset, while the time required for drafts to reach Federal Reserve Banks other than that upon which drawn would be at least the mailing time between the districts involved and usually longer.

3/21/16.

PLAN NO. 7MEMORANDUM AND SUGGESTIONS ON THE SUBJECT OF BANK RESERVES
AND THEIR RELATION TO THE SUBJECT OF THE
CLEARING AND COLLECTION OF CHECKS

(Submitted by Mr. Frederic H. Curtiss, of Boston)
Under date of March 28, 1916.

The reserve of a bank is that percentage of its deposits that it should carry uninvested to meet the demands of its depositors. There are two kinds of reserve; normal reserve, and excess or insurance reserve. The normal reserve of a bank should be based on the maximum demand of its depositors in normal times. An excess or insurance reserve is the reserve set aside to meet abnormal or unusual demands; that is a sort of insurance fund.

Reserves should be real; that is, cash in a bank's own vaults or a deposit in a Federal Reserve Bank. The character of the deposits of a bank varies the percentage of reserve needed. The character of a bank's deposits are as follows:

Savings accounts; - require small reserve,
Individual or personal accounts; - require a higher reserve than
the preceding,
Commercial accounts; - require a higher reserve than the preceding
Bank accounts; - " " " " " " " "

There are two kinds of normal reserve:

1. To meet ordinary counter demands,
2. Reserves to be carried at an exchange center to furnish exchange to its depositors, either in the form of checks drawn by the bank on that center, or by exchange created by customers sending their own checks afar.

As for the reserve for counter purposes, a bank can gauge its own counter demands and can be trusted to keep cash on hand to meet them.

The reserve to be kept elsewhere must be proportionate to its exchange transactions; that is, either the demand of its customers for checks on an exchange center (e.g. Federal Reserve city) to be used in paying bills elsewhere, or exchange created by its customers through paying bills elsewhere with their own checks. This outside reserve, therefore, pertains chiefly to two kinds of bank deposits; viz., commercial and bank. The excess reserve, that is, the reserve for insurance purposes should be held in a Federal Reserve Bank and should be based on all the demand deposits of a bank and the percentage, therefore, should be based somewhat upon the character of the city or town in which the bank is located.

In connection with the composite plan of clearing (i.e. Plan 4) the following problems arise.

1. The figuring of reserves,
2. Those arising from deferred credit and debit,
3. Charges for service and exchange,
4. The handling of checks on non-member banks.

1. The figuring of reserve.

Although this plan by direct routing of checks originating outside of the district, will materially reduce the float on those the country bank will never be satisfied to maintain its reserve on a deferred basis plan, and besides, the bookkeeping called for is too intricate for the country bank; hence we must make up out

our minds to allow country banks to figure their reserve as they do now, from their own books. By so doing, the reserve bank will receive additional balances from the outstanding checks drawn by the country bank on it, and by time items which it has collected and credited, and which the country bank will not debit on its books until advice is received. It will be the duty of the Comptroller of the Currency to see that every member bank maintains its reserves by its own books up to the requirements of the legal minimum.

On the other hand, the member bank, both in the Federal Reserve city and elsewhere in the district, must carry its "excess" legal reserve with the Federal Reserve Bank of its district, this reserve account being figured from the books of the Federal Reserve Bank, the member banks being obliged each week to send in a statement of their net liabilities so that each Federal Reserve Bank can see that the proportion of reserve is maintained. In other words, this is, as we have said, in the nature of an insurance fund and this reserve the Federal Reserve Bank must see is maintained.

2. Those arising from deferred credit and debit.

In the case of immediate credit and immediate debit: we are troubled with:

- a. The question of overdrafts,
- b. The question of float.

In this connection it is to be noted that the overdraft and float are analogous when taken as a whole and not as they pertain to the individual bank. On the other hand deferred debits and credits involve complications distasteful to small banks.

It has been customary, under the note circulating system to require a redemption fund at some central point to take care of notes circulating throughout the country, as, for instance, under the National Bank Act the 5% redemption fund in Washington. The circulating of bank notes is similar to that of bank checks except the latter circulate faster, and, therefore, require a larger redemption fund.

If we can cause each bank outside of a reserve city to maintain a redemption fund proportionate to what is ascertained to be its normal clearings, we shall have solved the problem. The total of these funds will readily take care of the float. We can accomplish our purpose if we allow member banks $1\frac{1}{2}\%$ interest on excess balances, a rate lower than the going rate allowed on bank balances, and which would, therefore, induce the country banks to transfer their surplus balances to the city banks, at the same time charging 2% interest on current overdrafts, current overdrafts being for the day's business, and charging one-half of one per cent above the current bank rate on overdrafts that a bank has had time to cover. This excess reserve which serves as a redemption fund, will only pertain to banks outside the Federal Reserve cities, and would be for clear-

ing purposes, while banks in the Federal Reserve cities would be enabled to make good their clearings by cash in their own vaults or by buying and selling exchange, or by rediscounts with the Federal Reserve Bank.

3. Charges for service and exchange.

It is proposed that Federal Reserve Banks shall handle all member checks at par, each member bank being charged a rate per item based on the cost of the collection department of each Federal Reserve Bank, but on some general rule to be promulgated by the Federal Reserve Board. Under the Federal Reserve System the cost of exchange is reduced to a minimum; members of a Federal Reserve Bank are able to create exchange by rediscounts with its own Federal Reserve Bank and such exchange will be current throughout the United States. In this connection it may be necessary to differentiate between drafts on a Federal Reserve Bank and exchange transactions. That certain small country banks are living off the exchange charged on their own checks does not appear fair. An exchange charge, if one is made should be assessed against the drawer or maker of the check and not the receiver and depositor of a check. Furthermore, it should be against public policy to allow a collection charge to be made by a member bank against its own checks.

4. The handling of checks drawn on non-member banks.

There is no reason why the Federal Reserve Banks should not

agree at the outset to accept non-member checks on all Federal Reserve cities on terms similar to checks on member banks in Federal Reserve cities, for those checks can be presented at the counter. Checks within the district on non-member banks remitting at par to the Federal Reserve Bank should be handled on a deferred basis similarly to member checks on other districts and here again a member bank might send those checks to the Federal Reserve Bank of its own district, giving immediate credit on its own books and count them as reserve, the Federal Reserve Bank handling this item similarly to items on other districts.

Checks on non-member banks in other districts, outside of Federal Reserve cities should be forwarded through the Federal Reserve Bank of the District of origin only as collection items for deferred credit.

In connection with the handling of non-member checks within the district on certain specified points, arrangements might be made, where the trend of exchange warrants it, that non-member checks might be cleared through specified member banks; that is, charged to the account of a member bank and forwarded for presentation and collection by the member bank.

BOOKKEEPING UNDER THE COMPOSITE PLAN.

(Plan 4)

1. Record books of member banks,
2. Record books of Federal Reserve Banks.

It is proposed that each member bank shall keep only one

account on its books with the Federal Reserve Bank, as it does now with its city correspondent, debiting at once to that account all cash items that it sends for collection whether to its own or to other Federal Reserve Banks, and debiting time items only when advised of their payment by its Federal Reserve Bank. The member bank will figure its reserves, therefore, from its own books on the basis of this account.

On the other hand, the Federal Reserve Bank shall maintain two accounts with each member bank, the reserve account and the exchange redemption account. The reserve account will be comparatively inactive and will be adjusted either weekly or monthly as a member bank's net deposits increase or decrease, the account to be based on the average for the preceding period.

The exchange or redemption account will be maintained only by banks outside of Federal Reserve cities, (banks in the Federal Reserve cities being able to redeem or settle for their checks by cash from their own vaults or through the sale of exchange or the making of rediscounts.) This exchange or redemption account will be the active account which the member bank outside of the reserve city will draw against; to which cash items within the district will be credited upon receipt; and cash items drawn on other districts and time items will be credited when paid. This account will be credited with interest on balances and charged interest on overdrafts irrespective of the reserve account. A statement of this account will be sent daily to the member bank.

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S U P P L E M E N T A R Y

An arrangement might be made with non-member banks along the following lines:

1. Non-member banks might be permitted to have their checks redeemed or settled for by a member bank in a Federal Reserve city, on a plan similar to that of member banks in Federal Reserve cities.
2. We might allow such non-member banks to print some statement or announcement that their checks were handled with Federal Reserve Banks without charge for exchange.
3. We might restrict member banks in the Federal Reserve cities handling of non-member bank checks through the Federal Reserve Banks only to the check of banks which have agreed to this redemption plan, endorsing or stamping on the checks some device stating that fact.

P L A N N O . 8

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SUGGESTIONS SUBMITTED BY THE GOVERNOR OF THE FEDERAL RESERVE
BANK OF ATLANTA, UNDER DATE OF MARCH 24, 1916,
FOR THE CLEARING AND COLLECTION OF CHECKS.

FIRST:

I would suggest that the officers of the Federal Reserve Banks be authorized to inaugurate a clearing house, which I believe they have a right to do on the approval of your Board, as set forth in Section 16 of the Federal Reserve Act. I also note that the cost of operating a clearing house under these conditions, can be charged into expenses against the banks using the clearing house.

SECOND:

I suggest that credits be deferred for two days within each of the Federal Reserve districts for checks collectible in the district and deposited by the member banks; and that from four to six days be allowed as deferred payment for checks payable in the other Federal Reserve Bank districts, according to distance.

THIRD:

That an Inter-District system be created between the Federal Reserve Banks similar to the clearings now taking place in the gold fund.

FOURTH:

That the Federal Reserve Bank be permitted to receive on the endorsement of the member banks, checks on State banks, private banks, savings banks and trust companies, as well as on their member banks, which I think is covered by open market transactions, as set forth in Section 14.

FIFTH:

That the Federal Reserve Board establish a zone system as to the allowance for exchanges, and for the experimental stage, would suggest the following:

On checks drawn on banks in towns or cities up to 3,000 inhabitants, according to the last census of the United States, and to be changed at each census period, that the bank to whom these checks are sent for collection be permitted to charge $1/8$ of 1% for the remittance of such items. (My conclusions for this arbitrary stand, is that the National Bank Act permits banks to be organized in places of this size with a capital of \$25,000, and this size bank is dependent largely upon collection charges on checks to sustain their expense account.)

On all towns or cities, subject to the same rule of the census, of 3,000 up to 10,000 inhabitants, the banks be permitted to charge $1/10$ of 1% for remittances and collections.

That banks in all towns or cities of 10,000 up to 25,000 inhabitants be permitted to charge 50¢ per \$1,000 on all collections and remittances.

That all towns or cities above 25,000 inhabitants collect checks at par.

That the Reserve Bank be authorized to charge the depositing bank the cost of exchange as above referred.

That in the event no member bank is located in a town or city, then the Reserve Bank may choose a State bank, trust company, savings bank or private bank, located in that town, to whom it may send the items

drawn on that town, provided said bank will agree to collect at the said rate. In the event no bank not a member, be willing to collect at these rates, then the postmaster in that town be authorized to collect these checks, deducting as remuneration the same fee as would be allowed to the member bank thus located.

SIXTH:

That the overhead cost of collecting these items be determined by two units; one unit to be the aggregation of the total face value of the items handled, and the other unit to be for the number of items handled. An equalization between these two should determine the charges to be made for this service.

SEVENTH:

That the Federal Reserve Bank should determine when the item had reached its maturity of deferred payment, and immediately credit the same into the reserve account of the member bank thus producing the credit, and correspondingly charge transit account with the same.

EIGHTH:

That the Federal Reserve Bank shall not be responsible for the loss arising from any item, and shall not be held responsible until it has received ultimate final payment for said item.

4/6/16

P L A N N O . 9

PLAN SUBMITTED BY MR. GEORGE O. BORDWELL, CASHIER OF THE
 FEDERAL RESERVE BANK OF SAN FRANCISCO, UNDER DATE
 OF MARCH 24, 1916,
 for the
 CLEARING AND COLLECTION OF CHECKS, WITH IMMEDIATE
 CREDIT AND DEFERRED DEBIT PROTECTED BY
 INTEREST CHARGE ON FLOAT.

Federal Reserve Bank to receive, for immediate credit and deferred deb-
 .it checks and drafts upon any member bank or non-member bank

(Federal Reserve Bank carries member banks' Transit
 Account but is protected by deposit of optional
 reserves)

Interest charge at higher than 90-day discount rate to be made
 to depositing banks on amount of outstanding items minus
 excess of reserve deposits over required reserve deposits

(Member bank carrying with Federal Reserve Bank
 excess deposits equal to full amount of float
 pays no interest)

Time schedule for interest charge to cover average time by States,

"San Francisco, immediate, California three days, Oregon
 five days, etc.".

(Great advantage to San Francisco Banks)

Exchange paid by Federal Reserve Bank to be debited back to
 depositing banks.

Transportation charges to be paid by Federal Reserve Bank on
 shipments to cover excess collections forwarded by Federal
 Reserve Bank to banks which remit at par.

Service charge

on interdistrict cash items say 20¢ per \$1,000

on intradistrict cash items rate based on actual cost in-

cluding transportation charges,
 not retroactive. say 10¢ per item
 on collections - - - -

(Reduction of cost to member banks in operation of
 their Transit departments should largely offset
 total service charges)

Transfer drafts and special items received for deferred credit.

The plan suggested will:

- make it advantageous for member banks now collecting own out-of-town items to deposit them with Federal Reserve Bank (see illustration)
- make it practicable for all member banks to route items through Federal Reserve Bank
- permit banks to control their balances
- give incentive to carry excess balances with Federal Reserve Bank, at least to the extent of optional reserves which in amount approximate estimated float
- protect Federal Reserve Bank from extensive involuntary loans through check collections.

I L L U S T R A T I O N :

(applicable November 1917 to member banks now collecting own items)

A member bank now handles \$4,050,000 cut-of-town items in one month;
 California \$3,000,000; Oregon \$600,000; Washington \$450,000;
 outstanding 3, 5 and 7 days respectively

Average items outstanding - - - - -	\$505,000
Reserve requirements now reduced by deducting float from bank deposits - - - -	\$75,000
Required reserve deposits - - - - -	600,000

- 3 -

586 - h.

Optional reserve deposits - - - - -	400,000
Reserve requirements to cover \$400,000 increase in net bank deposits would be increased - - -	60,000
<hr/>	
Total unproductive funds, member bank collecting own items - - - - -	1,505,000
90-day discount rate - - - - -	4 1/2%
Rate of interest charge on collections - - -	6 1/2%

WITH FEDERAL RESERVE BANK COLLECTING ALL ITEMS:

Unproductive funds reduced to - - - - -	1,060,000
If only minimum balance maintained, interest charge - - - - -	2,735
If balance increased by deposit of optional reserves interest charge - - - - -	569
If additional deposit maintained of \$105,000 interest charge - - - - -	none
unproductive funds - - - - -	<u>1,165,000</u>
Gain in loanable funds through Federal Reserve Bank collecting items - - - - -	340,000

RESULTS:

Member bank, by routing items through Federal Reserve Bank,

increases loanable funds \$340,000

at same time, avoids interest charge of \$2,166 by depositing
with Federal Reserve Bank optional reserves otherwise unpro-
ductive,

at same time, avoids interest charge of \$569 through excess
deposit of \$105,000 to cover remaining items,
(this deposit only necessary when float exceeds optional reserve)

is encouraged by lower discount rate to borrow by rediscounting
rather than through failure to maintain latter deposit.

DEFINITION:

Plan 1	Proposed by Federal Reserve Agents Optional	Deferred credit and deferred debit with option of immediate credit and immediate debit.
" 2	Proposed by Governors Mandatory	Deferred credit and deferred debit
" 2a	Now partially operated in District 12 Optional	Deferred credit and deferred debit
" 3	Proposed by Messrs. Rowe & Davis Mandatory	Immediate credit and immediate debit
" 3a	Now partially operated in District 10 Mandatory	Immediate credit and immediate debit
" 3b	Now partially operated in 9 Districts Optional	Immediate credit and immediate debit
" 4	Composite of suggestions Mandatory	Deferred credit and deferred debit limited to one-way time for points more than one day distant
" 5	Now partially operated in District 11	Immediate offset for each bank's incoming and outgoing items with deferred credit and deferred debit for resultant balances
" 6	Proposed by Ray M. Gidney Mandatory	Deferred credit and deferred debit with float pro-rated and loans authorized at current discount rate
" 7	Proposed by Geo. O. Bordwell	Immediate credit and deferred debit protected by interest charge.

4/7/16

ITEMS HANDLED:

- 1 proposes to handle a portion of items on member banks and all on State banks;
- 2, 3a, 4 & 5 provide for handling items on all member banks;
- 2a & 3b provide for handling a portion of the member bank items;
- 3 proposes to handle all member bank and some State bank items; but to make discriminatory charges against State bank checks;
- 6 proposes to handle all member bank and some State bank items;
- 7 proposes to handle all items.

THE FLOAT:

- 1 leaves burden with depositing banks, except when immediate credit and debit availed of;
- 2 & 2a leave burden with depositing banks;
- 3, 3a & 3b attempt to pass burden to drawee banks; actual results: Overdrafts and depleted balances at Federal Reserve Banks;
- 4 leaves burden with depositing banks for one day items and with Federal Reserve Bank or drawee banks for return trip on more distant items;
- 5 distributes burden in uncertain and constantly varying proportions between endorser banks, drawee banks and other banks which are neither endorsers nor drawees;
- 6 attempts to pro-rate to depositing and drawee banks with permit to withdraw pro-rated average outstanding funds at current discount rates;
- 7 places responsibility direct upon Federal Reserve Bank but offers depositing banks effective inducement to carry excess deposits to cover.

CONTROL OF BALANCES:

- 1, 2, 2a & 7 permit member banks to control their balances;
- 3, 3a & 3b do not give member banks control of their balances;
- 4, 5 & 6 give member banks only partial control of their balances;

EXCHANGE CHARGES:

on member bank: unless to discuss pending legal decision or
checks : legislation either requiring drawees to cover
at par or authorizing exchange debited back
to depositing banks' accounts;

On State bank plans 3 and 6 propose flat rate to be paid all
checks : drawee banks to debit of depositing banks'
accounts

plan 7 leaves open question of paying exchange
but provides for debit to depositing banks'
accounts for such exchange as may be paid.

A M E M O R A N D U M
TO THE GOVERNORS OF THE FEDERAL RESERVE BANKS

by F. A. Delano.

Washington, April 7, 1916.

A general statement of the reasons why the time has come for the Federal Reserve Board to put into effect a check clearing system which, even if not complete to start with shall be the foundation of a structure which may be completed with reasonable dispatch and which, while not requiring member banks to avail themselves of the new facilities, will give the privilege to every member bank that wishes to make use of them.

FIRST:

It is very evident that the Federal Reserve Law, while not absolutely mandatory, or entirely specific in its requirements about clearing, certainly contemplates that the Board shall establish a check clearing and collection system, which shall include in its adherents all member banks, and furnish an effective collection agency for checks drawn on member banks in all districts.

SECOND:

The shifting of reserves from banks in reserve and central reserve cities to Federal Reserve Banks would, in effect, deprive many banks in the country of opportunities for check clearing and collection which they have heretofore enjoyed. The framers of the Federal Reserve Act, having this in mind, saw that they must create a machinery to perform the functions which correspondent banks had previously performed in return for bank balances.

THIRD:

The criticism is made that, whereas, banks in central reserve and reserve cities have in the past carried the reserve balances of their client banks, have paid interest on those balances, and rendered important services in the matter of check collection and clearing, and in other ways as well, it is strange that the Federal Reserve Banks, which pay no interest on reserve deposits, hesitate to perform this service on the score of expense. Hesitation to assume clearing and check collection functions is the more strange because of the fact that the strategic position of the Federal Reserve Banks is such as to make it possible for them to handle this business at a much lower cost than it can be handled under present conditions and with present methods. The additional expense which such operations will entail to the Federal Reserve Banks has doubtless been overestimated and it may well be pointed out that as the overhead expense is already largely provided, the additional expense will be mainly mechanical and clerical, and therefore moderate and proportional to the volume of the checks handled.

FOURTH:

With each successive transfer of reserves (the complete transfer having already been made in central reserve cities and the final payments as to reserve cities being due in May, 1917, and in non-reserve cities in November, 1917), there is increased necessity and demand for a complete and satisfactory clearing system.

- 3 -

FIFTH:

In discussing the clearing system, reference has been made frequently to various evils in banking practice which have grown up in the past fifty or more years; for example, the common practice by banks in central reserve and reserve cities allowing immediate credit and deferred debit on country bank items; or the practice whereby exchange charges are assessed against the depositor or indorser of the check, rather than the drawer or maker. These and other practices which might be mentioned, all more or less vicious in character, should be corrected, and doubtless will be corrected or modified in future years; but it certainly would be unwise to undertake too many reforms simultaneously or impose upon any proposed check clearing plan the burden of all the desirable reforms. Doubtless we can check some of these evil practices now, can reduce "float" by more direct routing of items, and build up a machine which will be able gradually to effect other reforms, but we must not attempt to do it all at once.

SIXTH:

An important feature in the development of American banking in the last two generations has been the development of book credits in the form of deposits, rather than note issues. European banks, and especially those of continental Europe, give credit to a borrower in the form of bank notes. In the United States the extension of credits has taken the form chiefly of book credits. The immense system of

State banks and trust companies which has developed so phenominally in late years has long been denied note issuing powers, and even the national banks use the note issuing power to only a relatively small extent.

Hence, it is a mistake to assume that the chief function of the Federal Reserve Banks is to be that of note issuing. On the contrary, it is but fair to expect that as the years roll by their more important functions will be the extension of book credits to their members and currency only in crop moving seasons or in times of stress. But member banks will not go to the Federal Reserve Banks for book credits or balances in excess of legal minimums unless these balances can be of some service to them. If there is no check clearing system - if there is no system by which they can issue drafts drawn on Federal Reserve Banks, or send them to their correspondents, they will not care to avail themselves of these credits. This character of service will bring the member banks and the Reserve Banks in daily contact, whereas, the note issuing feature will only bring that contact at rare intervals.

Hence, it may be fairly said that the success and development of the Federal Reserve System depends quite as much on a good system of check clearing as on any other single feature.

4/7/15.

P L A N N O . 1 0 .

A CLEARING AND COLLECTION PLAN

Being an Evolution of the plan submitted by Mr. Lyman H. Talley
(Proposed by Mr. M. J. Fleming, Assistant Cashier, Federal
Reserve Bank of Cleveland, under date of April 7, 1916)

For the utmost possible development of the check as a medium of exchange, it is obviously essential to cure the serious evils which have grown into the present methods of check collection. Four purposes must be sought:

- 1: Minimize the life of the check;
- 2: Minimize the volume of "float" carried by the banks, especially that large part which is now fallaciously and dangerously counted as reserves;
- 3: Minimize the cost of collection, and eliminate exchange charges;
- 4: Place the cost of the service where it belongs.

The plan of deferring debits and credits by schedules will shorten the life of the average check, and will greatly reduce the float, but will leave a considerable volume of float to be carried by the Federal Reserve Banks. Its principal objection, however, is that it would be a radical reform, strange and novel, necessarily compulsory, and therefore unwelcome, and so it might drive member banks out of the system.

It will be acknowledged that the application of the clearing house principle would be the ideal solution of the problem if it is practicable and that clearing house operations could accomplish all

the purposes above named. The Act recognizes the clearing house principle in terms; and a country-wide clearing house being obviously impracticable provides that the Federal Reserve Board "may require each Federal reserve bank to exercise the functions of a Clearing House for its member banks."

The plan herein proposed is an evolution of the "Reserve City Clearing House" as now operated in the Dallas district. Practically all of the "Outline of Fundamental Principles" submitted by Governor Van Zandt is applicable to this plan which therefore has the merits so well urged therein for Mr. Talley's plan; so it is unnecessary to repeat herein the fundamental principles of that plan, which are (without leave) "hereby made a part of this report." The features now proposed to supplement or modify the Talley Plan are as follows:

1. All Clearing House membership being essentially voluntary, member banks should be given the option of joining the Federal Reserve Bank Clearing Houses or accepting deferred credit and debit.

2. The Clearing House Departments of Federal Reserve Banks should be entirely independent of the Reserve Banks themselves; that is, the reserve accounts of member banks should be kept entirely distinct from the Clearing House accounts. Credit balances in the Clearing House when collected from debtor banks should however be deposited to the credit of the member bank's reserve account in the Federal Reserve Bank. Debtor banks should settle for debit balances by drafts on the Federal Reserve Bank to the order of the Clearing House department or manager, as provided in the Talley Plan.

A debtor bank obliged to ship currency to meet its settlement draft should be credited with the actual minimum cost of such shipment, as in the Dallas system; but it is believed that such cost should be charged to the general operating expense, rather than to attempt to charge it against the banks clearing items on the shipping bank, which would involve much clerical work.

3: Each Federal Reserve District should be divided into a suitable number of sub-districts for clearing house purposes only; each such sub-district to contain a Clearing House Agency of the Federal Reserve Bank. Each such Clearing House Agency should be a member of each other Clearing House Agency in the same Federal Reserve District. Each member bank should send all items on other member banks located within its sub-district to the Clearing House Agency thereof, and should send all items on member banks of other sub-districts within the same Federal Reserve District, direct to the Clearing House Agency of the sub-district in which the payer bank is located, with a duplicate letter to its own Clearing House Agency. This Agency, being a member of all other Clearing House Agencies in the Federal Reserve District, receives credit on the clearing sheet of the payer bank's Clearing House Agency, and its balances will be offset in the same manner as balances between other members of that Clearing House Agency. All balances, however, should be settled on the books of the Central Clearing House at the Federal Reserve Bank; and there the offsets will probably be such as to obviate the necessity of apportioning credits as in the Talley Plan. Resultant balances between

the several agencies would also be settled through the Central Clearing House Department at the Federal Reserve Bank.

4: Items of non-member banks may be cleared through member banks, as is now the custom in some local Clearing Houses. For the service of clearing or collecting items presented by member banks, but bearing the indorsement of non-member banks, an additional discriminatory charge should be made.

INTER-DISTRICT OPERATIONS

5: The handling of checks payable outside of the Federal Reserve District of the depositing bank, although involving deferred settlements, can be conducted in a similar manner. Member banks having items payable outside of their own Federal Reserve District could send all such items direct to the Clearing House Department of the Federal Reserve Bank of the district in which the payer bank is located, or to its sub-district Clearing House Agency; or to the payer bank direct if located in a center, but in each case for credit of the Clearing House Department of their own Federal Reserve Bank; at the same time sending duplicates of such letters to the Clearing House Department of their own Federal Reserve Bank. The payer bank's Federal Reserve Bank will then advise the depositing bank's Federal Reserve Bank. A bank having a small number of items payable in other Federal Reserve Districts might be permitted to send all such items to its own Federal Reserve Bank for sorting and transmission, although each member bank should be urged to send items

direct to the district where payable whenever possible to avoid delay in transit. Resultant debit or credit balances in the Inter-district system should be settled in the same manner as those in the Intra-district Clearing House with the exception that they would be cleared through the Gold Settlement Fund.

EXPENSE OF OPERATION.

6: The expense of maintenance and operation may be provided for as suggested in the Talley Plan as far as Intra-district clearings are concerned. In Inter-district operations a Federal Reserve Bank Clearing House receiving items from banks in other Federal Reserve districts direct should not enter any item charges upon its books, but the Federal Reserve Bank of the District where such items originate should make an item charge from the duplicate letter of advice received by it from its member bank which has sent the items to the other Federal Reserve District.

The item charge for both Intra and Inter-district items should, of course, be sufficient to cover all incidental expenses, including any necessary remittances of funds.

4/7/16

P L A N N O . 1 1 .

FEDERAL RESERVE BANK OF ST. LOUIS.

THE FOLLOWING PLAN FOR THE COLLECTION OF CHECKS IS INTENDED TO SHOW:

WHAT WE BELIEVE SHOULD BE DONE;
THE REASONS WHY WE BELIEVE SO;
AND THE METHODS PROPOSED TO ACCOMPLISH IT.

<u>FUNDAMENTALS:</u>	<u>REASONS:</u>	<u>METHODS:</u>
1 - All member banks should receive at par checks drawn on them, which have been deposited in the Federal Reserve Banks. This should be mandatory.	This is based upon the last two paragraphs in Sec. 16 of the Federal Reserve Act.	It should be put into effect by orders issued by the Federal Reserve Board.
2 - The Inter-District exchange of checks should be put into effect simultaneously with the mandatory collection of checks on members.	Any practical method of collecting checks must include means for the passing of a check from the District where it is negotiated to the District where it is payable.	Federal Reserve Banks shall receive for credit from other Federal Reserve Banks checks drawn on points in the former Banks' Districts. Further details are given under Sec. 6.
3 - Federal Reserve Banks should receive from Member Banks, and other Federal Reserve Banks checks drawn on Non-member banks, on the basis of the exchange cost on such checks.	Recognition must be given to conditions actually existing. The National Banks are now handling 75% to 80% of the country checks in circulation, consisting of checks on Members and on Non-member banks. The checks on Members will be turned into the Federal Reserve Banks, who will therefore accumulate 75 to 80% of the checks drawn on their members; and the members will have to provide payment for them to the Federal Reserve Banks. Some assistance should be given to the Country Member to restore its reserve balances thus depleted by the Federal Reserve Bank.	A start can be made by collecting checks on non-members located in the same place as a member - at par if possible, at a slight service cost if necessary. The Federal Reserve Bank will then begin negotiations with non-members located in places where there are no members for the collection of checks on such

FUNDAMENTALS:REASONS:METHODS:

3 - (Continued)

Owing to the greater number of State Banks, the outside checks received by a country member are mostly drawn on State Banks in the vicinity. Some are drawn on National Banks, which can of course be sent to the Federal Reserve Bank, but these do not by any means provide a fair offset to the payments the country member has to make to the Federal Reserve Bank. To say to the country member bank that it can restore its depleted balance by sending a check on its City correspondent is to say: "We leave you where we found you, and you must find the means to offset a situation created by the Federal Reserve Bank." The equitable way is for the Federal Reserve Bank to provide the member bank with the means to convert all of its outside checks into a credit balance in the Federal Reserve Bank, at a minimum expense to all concerned. The collection of country checks will not in practice prove to be such a tremendous country-wide affair as first appears. The outside checks received by a country bank are largely drawn on banks in its vicinity and by far the larger part of them would not go outside of the Reserve District in which the Member is located if the Federal Reserve Bank undertakes their collection, and declines to receive from another Federal Reserve Bank checks already endorsed by a bank located in the district of the receiving Federal Reserve Bank. The collection of country checks will resolve itself into a local proposition.

banks, on as favorable terms as possible, in exchange which is convenient to the remitting bank and convertible by the Federal Reserve Bank. Since the twelve Federal Reserve Banks will become the largest collectors of country checks, they will secure the lowest rates from the banks who charge exchange. They will be in position to offer certain advantages to non-members who remit at par, as will be explained in Section 4. The manner of giving credit to the sending member bank for checks on Non-members will be explained further on.

4 - The Federal Reserve Banks should differentiate between Non-member banks who remit at par for checks sent them by Federal Reserve Banks and those who charge.

Under any comprehensive plan of collecting country checks a Non-member can receive by virtue of a connection with its City correspondent all of the advantages of the collection facilities of the twelve Federal Reserve Banks. Unless some distinction is drawn between the Non-member

The differential charge shall be the same rate of exchange which is charged by the endorsing bank on items sent it by the Federal Reserve Bank. The rate will be as-

FUNDAMENTALS:

4 - (Continued)

This should be a charge made on account of the endorsement of a Non-member bank which does not remit at par for the Federal Reserve Bank. The enforcement of the differential charge will be voluntary on the part of the drawee bank, as explained in the reason for levying the charge.

REASONS:

who remits at par for the Federal Reserve Bank, and the one which will not, the latter bank receives an undue advantage over the former and also over Member Banks. A way should be found to equalize this discrimination and offset the undue advantage given the Non-member who seeks to enjoy the facilities of the Federal Reserve Banks and make a profit from them at one and the same time. It is proposed that the Federal Reserve Bank charge exchange on any check, which reaches it, that is endorsed, by a Non-member who charges for remitting to the Federal Reserve Bank. This differential charge shall be at the same rate of exchange as the Non-member charges the Federal Reserve Bank. The exact amount of this charge is to be paid to the Bank on which the check is drawn, if the drawee bank remits at par for checks sent it by the Federal Reserve Bank. It is apparent that the Federal Reserve Banks can by this means have a definite advantage to hold out to the bank who will remit to it at par. It is true Member banks have been urged to join the clearing system, now in use on the ground that they can have their customers' checks collected at par through the Federal Reserve Bank. This differential charge will effect this to a certain extent; but it will return the Member Bank the exact amount of the charge levied on its customers' checks, putting it in position to return it to the customer; OR, IF DESIRED BY THE MEMBER BANK, no differential will be imposed on its customers' checks on account of endorsement, if it prefers this to being paid exchange on them.

METHODS:

certained from the negotiations to be carried on as explained under Sec. 3. The charge is to be levied against the depositing member bank. The charge is to be levied by the Federal Reserve Bank in which the item is first deposited. The Federal Reserve Bank of the District will know what banks in its District are charging exchange. It is apparent that the bulk of the outside items endorsed by these charge-banks will be offered to the Federal Reserve Bank located in its District. (See last paragraph in "REASONS" Sec. 3). The amount of the charge will be noted on the letter of transmittal carrying the item from the Federal Reserve Bank to the Member Bank or another Federal Reserve Bank. The check charged on will be indicated by a symbol opposite the check. A coupon at the foot of the letter will name the amount of the check on which the differential has been levied, amount of the charge and contain a request to deduct

FUNDAMENTALS:

4 - (Continued)

REASONS:

The bulk of the exchange charges on checks is levied by country banks in the smaller towns and cities. It is no secret that the evil of exorbitant exchange charges is rooted in the competition of reserve city banks for accounts of country banks. Experience of the past twelve months has demonstrated that little assistance can be expected from interests outside of the banks in the solution of this exchange problem. The first step towards a solution must be reached in the relations between a country bank and its reserve city correspondent. By imposing a differential charge on the checks, which can be deposited in a Federal Reserve Bank, the Reserve City bank will soon have two plans which it can extend to the country bank for the handling of its items. One plan to the bank which remits at par for the Federal Reserve Bank (Whose items can be deposited through a Member at par in the Federal Reserve Bank) and a second plan for the bank which charges the Federal Reserve Bank and whose items are therefore subject to a charge if deposited in the Federal Reserve Bank. The profits to the reserve city bank will be quite different on the first class from the profits on the second class of accounts. This wide difference in profits will soon effect the basis upon which the reserve city bank can receive the country account. Country banks will, by their own volition, divide themselves into two classes. Those banks, having a large volume of outside checks to collect, will manifestly find it to their interest to par for the Federal Reserve Bank, while those having only a small volume of out-

METHODS:

the amount of it from next remittance, if the check is drawn on a non-member who pays; or if drawn on a member the coupon will be an advice of credit. If the letter of transmittal is to another Federal Reserve Bank, the notation will be an advice of credit for the amount of the differential. If the check is drawn on a Non-member who charges the Federal Reserve Bank, the amount of the differential will be retained by the Federal Reserve Bank, and used to reduce the cost of check collection. Member banks will be furnished with a list of the banks who charge the Federal Reserve Bank, so that they can arrange accordingly for handling items with charge bank endorsements. Federal Reserve Banks will not receive from other Federal Reserve Banks items bearing the endorsement of member or non-member banks, located in the second Federal Reserve Bank's District. All Federal Reserve Banks

FUNDAMENTALS:REASONS:METHODS:

4 - (Continued)

side checks may prefer to charge the Federal Reserve Bank and pay the same rate on the outside items it may receive from its customers. Eventually the number of banks charging exchange will be reduced to a minimum.

will exchange with each other lists showing rates of exchange paid to the various non-member banks.

5 - The twelve Federal Reserve Districts should be sub-divided and Sub-Agencies established for the collection of checks in the immediate vicinity of the Sub-Agency. The distribution of Sub-Agencies should be so arranged that the majority of banking points in the Reserve District are within one day's time from a Sub-Agency.

This is following long established lines of practice in the collection of country checks. The commercial banks of the country have found it necessary to distribute country checks through 50 to 60 centers. Experience has developed the necessity for this. The Sub-Agencies should be so located that a majority of the banking towns in the sub-district are within one day's time from the Sub-Agency. This will enable a remittance containing checks on members to be credited the next business day after receipt at the Sub-Agency, and enable remittances of checks on Non-members to be credited two days after receipt at the Sub-Agency. The principal argument advanced against the parring of checks has been the cost to the paying banks to make the exchange in which it is required to remit. If Sub-Agencies are properly located, banks remitting to them will remit in exchange which they make readily and which costs nothing.

Location of Sub-Agencies shall be designated by the Federal Reserve Bank. The Sub-Agencies may be Member Banks, but the men handling the items should be employes of the Federal Reserve Bank, under proper bond. A list of Sub-Agencies shall be furnished member banks in the district with instructions to send items in the Sub-District to the Sub-Agency. Receipts at each Sub-Agency may be telegraphed if necessary to the Federal Reserve Bank, and confirmed by mail. The manner of entry on the books of the Member Bank of remittances sent to the Sub-Agency is taken up further on.

6 - Checks on Member Banks or Federal Reserve Banks should be credited to the sending bank on the day the checks should reach the drawee bank. Checks on Non-Member banks should be credited on the day returns for same should reach the Fed-

It is the purpose of this method to enable X Bank to realize on a check drawn on Y Bank within the same period that Y Bank can realize on a check drawn on X Bank. It is intended that a check drawn on a Member Bank shall become reserve for the sending bank on the day the check reaches the drawee bank. The sending bank will accordingly charge the Federal Reserve Bank with remittances sent it on the day such

Member Banks will be furnished with forms of remittance letters which will show that the letter is addressed to a Sub-Agency, the Federal Reserve Bank of its district, or a Federal Reserve Bank or Sub-Agency outside of its District.

FUNDAMENTALS:

6 - (Continued)

eral Reserve Bank
collecting same.

REASONS:

remittances should reach the drawee banks. Its books will therefore correspond with the books of the Federal Reserve Bank.

What is usually termed in transit matters "the float" is the volume of checks which have been credited to depositors' accounts and are in process of collection. It grows out of the long established practice of giving credit on receipt to a depositor of checks on outside points. Manifestly the crediting bank receives some advantage in this manner of handling outside items. It is also plain that the drawee bank receives some advantage from the circulation of its customers checks drawn on it.

The above plan divides the burden of this "float" equally between the receiving bank and the drawee bank. It is proposed as being an equitable division. It is based on the belief that a Federal Reserve Bank can define when a Member Bank may count as reserve any checks deposited in the Federal Reserve Bank.

METHODS:

The form will show when the Member Bank is to charge the remittance to the Federal Reserve Bank. It may charge checks on the same city in which a Sub-Agency of Federal Reserve Bank is located to its reserve account one day after transmittal. Checks on other members in the District shall be charged two days after transmittal: Checks on Non-Members in the District may be charged three days after transmittal.

This will take care of the bulk of the outside checks received by the average country member. There will remain a small volume of checks on points outside of the District, which may be sent to the Federal Reserve Bank of the member's district or by arrangement to a Federal Reserve Bank located in the district where the checks are payable. It will not be difficult to arrange with the large collecting banks a practical convenient method for the handling of checks on points outside of their Federal Reserve

FUNDAMENTALS:

6 - (Continued)

REASONS:METHODS:

a matter which must be left to the discretion of the Federal Reserve Bank concerned. Remittances containing checks on non-members shall be separated from those containing only checks on Members. The exchange charges if any on checks on Non-Members will be assessed the depositing bank on receipt of the check, if within the District. If the check is drawn on a point outside of the district, the exchange will be assessed on receipt of advice of the collecting Federal Reserve Bank.

Exchange charges on non-member checks received from other Federal Reserve Banks will be assessed on receipt of the check, from the known schedules of charges which the Federal Reserve Bank will have on file from non-members in its District.

Lists showing time in transit will be furnished Members and Federal Reserve Banks.

It is recommended that the question be taken up later for adjustment, as to when drafts drawn by a member bank on its Federal Reserve Bank shall be deducted from the drawers balance on its books.

FUNDAMENTALS:

REASONS:

METHODS:

7 - Currency or coin shipments made by a Member to a Federal Reserve Bank shall be at the expense of the shipping bank, but shall be counted as reserve on the date the shipment is made by the Member Bank.

The establishment of Sub-Agencies will largely offset the need for currency shipments for purposes of making exchange. They will therefore be made principally as a matter of convenience to the shipping bank. They should be counted as reserve while in transit, since the currency would probably be reserve had it remained in the member's vault.

No details are needed. The shipments will simply be counted and credited on receipt.

8 - Checks representing transfers of funds shall be received on a basis to be fixed by the Federal Reserve Bank concerned.

This is to permit Federal Reserve Banks to engage in the purchase or sale of domestic exchange in accordance with conditions existing at the time of the transaction.

The manner of entry of such transfer checks is to be left to the discretion of the Federal Reserve Bank concerned.

9 - Reserves of Member Banks shall be computed from the books of the Federal Reserve Bank.

The carrying out of Section 6 will enable the Member Banks to have their books agree with the Federal Reserve Bank. The equitable division of the burden of uncollected checks is explained in the same Section; as is also set out the jurisdiction of the Bank in the calculation of reserves carried with it.

By direction of the Federal Reserve Board Member Banks shall make a periodical report of their reserve requirements. A comparison will then be available with the reserves actually carried. If any penalty be necessary on account of deficiency maintained over a given period it can then be fined as may be directed by the Federal Reserve Board as provided in Section 19 of the Act. The present method to continue until experience develops the necessity for change.

10 - Settlements between the Federal Reserve Banks in the Gold Fund should continue as heretofore until experience develops the necessity for more frequent

This recommendation carries its own reason.

The present method to continue until experience develops the necessity for change.

FUNDAMENTALS:

11 - That uniform methods should be followed by Federal Reserve Banks in the handling of Inter-District remittances.

REASONS:

Federal Reserve Banks should be enabled to have their books agree with every other Federal Reserve Bank at the close of business each day.

METHODS:

Uniform types of remittance letters should be adopted, showing when each remittance will be charged by the sending bank. Advices of credit by the receiving bank should show when the outside checks will be available for the sending bank. They should be held in a Transit account until the date the funds become available.

12 - The expense of operation should be left as a matter to be taken up later after experience has developed the approximate cost per item.

After a few months' operation, some definite figures will be obtained and from then on an equitable assessment of expense can be levied.

4/10/16.