

COLLECTION OF OUT OF TOWN CHECKS BY FEDERAL
RESERVE BANKS.

(By W. P. G. Harding)

This is a matter that has engrossed the attention of the members of the Federal Reserve Board and of the officials of the various Federal Reserve Banks, for more than twelve months. It has been the subject of many conferences and several plans have been suggested. The problem involves the handling of checks by a Federal Reserve Bank for its own member banks and also inter-bank transactions. The Gold Settlement Fund which was established by the Board about a year ago, may be regarded as a satisfactory method of adjusting balances between Federal Reserve Banks. In seeking a solution of the problems involved in the intra-district transactions, it would be well for the Federal Reserve Banks to approach the subject from the same angle that a newly established member bank would in its efforts to build up a profitable business. It should be borne in mind that the Federal Reserve Banks are not required or permitted to receive checks on deposit from the general public, but their contact with checks is limited to such as they may receive from their own depositors (their member banks) or from other Federal Reserve Banks. There has been no pressing need for radical changes in the present methods of collecting country checks,--

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an evolution after years of experience,--but, as has been pointed out frequently, it is the relation between the country check and the reserves which must be considered. After November 1917 no balances in any bank other than a Federal Reserve Bank will be permitted to count as reserve and it is probable that balances hitherto carried by country banks with their national bank reserve agents, will either be curtailed appreciably or withdrawn entirely. There is, always has been, and always will be, an actual expense attached to the collection of country checks. Possibly this expense may be reduced under the clearing methods of the future just as it has been reduced in the past, but there is no doubt that many banks have been deceiving themselves into thinking that they are put to no expense in the collection of their country checks, while an analysis would show in many cases that banks pay this expense indirectly by carrying balances with collecting banks that might be more profitably employed otherwise, and that they are really paying more for a collection service than other banks who meet the expense face to face and settle it as it accrues. A Federal Reserve Bank is a purely mutual organization. Its depositors are its stockholders and its borrowers are all stockholders. Each Federal Reserve Bank should hold itself ready to serve each one of its limited number of depositors as far as it can

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with safety to itself and with justice to its other depositor stockholders. Should any member bank desire to discontinue national bank reserve accounts that it has been carrying and ask a Federal Reserve Bank for the same collection facilities that had been extended by the National Bank reserve agent, such service should, without hesitation, be extended by the Federal Reserve Bank; not, however, at a loss to itself, which would be unfair to its other stockholding banks, but at cost or as near to cost as practicable. If the member bank which has been in the habit of counting as reserve, items in transit to its national bank reserve agent, desires the same privilege as to items sent to Federal Reserve Banks, it should be granted. But the Federal Reserve Bank should analyze each account in order to determine the average amount of outstanding items or float that it has permitted the member bank to count as reserve, and it should charge interest upon whatever amount of the apparent reserve carried is found to be made up of checks in transit. The actual cost of collection should also be ascertained and the proper allowance made for overhead charges. A statement of all this should be rendered the member bank once a month and the resulting charge made against its account. The Federal Reserve Bank should give full service to the member bank, including checks on state banks and trust companies and

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checks drawn on other banks in other districts, but it should require as a condition precedent, that each member bank sending checks for credit should agree that checks upon it may be charged against its account with the Federal Reserve Bank, immediately upon receipt by the Federal Reserve Bank, as a matter of convenience;--but on the books of the member bank as a matter of course, not until the member bank had received the items. In the analysis of the account to be made daily and rendered monthly by the Federal Reserve Bank, allowance should be made in computing the float against a member bank of the time in transit to it of items charged against its account on the books of the Federal Reserve Bank.

By following these principles, which are based merely upon the idea of adequate service with a compensating charge, the Federal Reserve Banks will gradually assume for their members the burden of collecting out of town checks. But it is not anticipated that the change will take place so rapidly as to embarrass the Federal Reserve Banks physically or otherwise. The actual cost which must be met frankly and which cannot be disguised or diluted, will no doubt appear high at first, and will cause many member banks to be slow to use Federal Reserve Banks as collecting agencies; but the fact that balances with Federal Reserve Banks count as reserve while those with other

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banks will not, will be a powerful leverage in the long run, and assuming that each member bank that uses its Federal Reserve Bank as a collecting agent will be required to permit the charge of checks on it against its account at par, it follows that the cost of handling items by a Federal Reserve Bank will be reduced from time to time as one member bank after another uses the Federal Reserve Bank as a reserve correspondent and collection agent. Those who deposit checks with the member banks, -- the public -- are already in many instances, owing to close competition between banks, getting free service, others may be paying by carrying free balances, while still others may be subjected to direct and sometimes excessive charges. But it is evident that as member banks are enabled to collect out of town checks at a reduced cost, this benefit will inure, in the last analysis, to their customers. Do not get away from the fact however, that the problem of collecting country checks with which the Federal Reserve Banks are confronted, is not one which has to do directly with the public, but concerns primarily the member banks. It is purely a matter of banking practice; it should be worked out on the basis of adequate service and proper compensation for service rendered.

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