

FEDERAL RESERVE BOARD
WASHINGTON

July 18, 1916.

Memorandum for the Board:

National banks are authorized by law to act as financial, and Federal reserve banks as fiscal, agents of the Government. In sustaining the constitutionality of Federal legislation on the subject of banking the court held that the Federal Government had the implied power to create banks as agencies or instrumentalities of the Government to be used in the conduct of its fiscal affairs.

The fiscal affairs of the Government may be briefly summarized as follows:

- A. Collection of Revenues,
- B. Disbursement of Appropriations,
- C. Marketing of Bonds,
- D. Refunding of Bonds.

The national banks aided materially in the marketing of bonds which are used to secure circulation. Machinery is furnished in the Federal Reserve Act for refunding these bonds. In the matter, however, of the collection of revenues and disbursement of appropriations the Government has utilized national banks to a limited extent only, and the present system which is a modification of the old independent treasury system is admittedly cumbersome.

COLLECTION OF REVENUES

Collectors of customs and of internal revenue deposit collections made with national banks designated as depositories by the Secretary of the Treasury; with the assistant treasurers of the United States, and with Federal reserve banks. In making collections they are authorized to accept checks drawn on and certified by banks located in the same city as the depository banks and such out of town checks as may be collected without expense to the Government. In practice the collectors of internal revenue frequently find it necessary to accept checks from almost any point in their respective collection districts. These collections are deposited the day received and the bank issues a certificate of deposit therefor in the name of the collector and credits the revenues to the Treasurer's general account, forwarding the original certificate of deposit to the Secretary of the Treasury through the office of the Treasurer of the United States, together with a daily transcript which shows receipts, the source thereof, and Government warrants and checks paid, the latter having been charged to the Treasurer's general account.

DISBURSEMENT OF APPROPRIATIONS

Under the provisions of Circular No. 5 all disbursing officers carry their accounts with the Treasurer of the United States, and draw checks against their respective balances, which have previously been placed to the official credit of such officers through

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an accountable warrant. These checks are honored by any depository bank at par and as above stated are charged against the Treasurer's general account, forwarded to the Treasurer of the United States at the close of business each day, and when received by him are charged against the balance of the disbursing officer whose name appears therein as the drawer of the check.

Prior to the issuance of Circular No. 5, disbursing officers carried their accounts with the various Assistant Treasurers of the United States and with depository banks.

OBJECTIONS TO PRESENT SYSTEM

Under this system of collections and disbursements the Public Monies Division of the Treasury Department is required to maintain a very large number of accounts on its books. These accounts must be carefully checked and the balances covered into the General Fund. The bank receiving the deposits from a collector issues its certificate which is sent through the Treasurer's office to the Secretary of the Treasury, Public Monies Division, and the amounts represented thereby are periodically covered into the general fund. If a check is received without certification and proves to be uncollectible or if a bank which has certified a check given to a collector fails before the check is paid, it is exceedingly difficult to make any proper adjustment, and the depository bank must necessarily assume a certain risk in handling these collections.

The method of requiring all disbursing officers to carry their accounts with the Treasurer of the United States is also open to criticism. I am informed that its operation is expensive and that it is in many respects unsatisfactory. The volume of checks constantly in transit is necessarily large, and these checks will normally remain outstanding even longer than the ordinary bank check. While it is necessary to maintain a large and expensive force to handle these checks when they reach the Treasurer's office, it appears to be impracticable for the present force to properly scrutinize and check the various items received before final payment is made and a certain unnecessary risk must therefore be assumed.

To illustrate, a disbursing officer in California draws a check on the Treasurer of the United States at Washington. This check is deposited in a bank in San Francisco; the San Francisco bank uses it to create exchange in Denver; Denver, in turn, uses it to create exchange in Minneapolis; Minneapolis may send it to Chicago, and Chicago to New York. When it finally reaches Washington it is necessarily covered with indorsements. The Treasurer's office before payment should first verify the signature of the disbursing officer, should see that the payee has indorsed it, that all subsequent indorsements are in order, and should check the object for which drawn which should be shown on the face of the check. I am advised, however, that with the present force it is not practicable to do this; that the signatures are not verified, the indorsements and object for which drawn are not checked, and that after checking the amount of each item against the account current

sent in by the remitting bank, the checks are filed.

If it becomes necessary to stop payment on such checks under the present system it is very difficult to do so, and in view of the incomplete records of the Treasurer's office it is also difficult to trace any particular item after payment has been made.

SUGGESTED CHANGES

It is respectfully suggested that the accounts could be simplified and the collection and disbursements of revenues more effectively safeguarded if a plan substantially as follows should be adopted:

- (1) The twelve Federal Reserve Banks have been designated as depositaries and fiscal agents of the United States Government. As such, they are authorized to carry funds to the credit of the Treasurer's general account. Under authority of Section 3620 Revised Statutes each Federal Reserve Bank might likewise be designated as a depositary for the accounts of all disbursing officers located in its Federal Reserve District.
- (2) The designation of national banks as Government depositaries might be continued, but they should not be designated as depositaries for any disbursing officer.
- (3) Collectors of customs and internal revenues might be permitted to deposit in member banks and such member banks might be authorized to issue certificates of deposit in the name of the Federal reserve bank of that district.

Each member bank, as at present, could be required to furnish bonds to secure such deposits, to pay interest thereon, and to remit all in excess of such security to its Federal Reserve Bank. The deposits thus made in member banks would stand to the credit of the Treasurer of the United States with the Federal reserve bank and not to the credit of the Treasurer of the United States with the member bank. The certificates of deposit could then be forwarded through the Treasurer as at present and he could charge the amount represented thereby to the account of the Federal Reserve Bank. In this way he would be required to maintain only twelve accounts instead of several hundred as at present. All disbursements could then be made by check on the Federal reserve bank of the district in which the disbursing officer is located, and these checks could be handled as any ordinary bank check and could be safeguarded by the usual precautions taken in such cases. The twelve Federal Reserve Banks could then furnish accounts current at regular intervals to the Auditor for the Treasury Department. The Treasurer of the United States would charge accountable warrants to the various disbursing officers and credit them by notice of auditor's settlement.

I am advised that such a system would result in a saving of several thousand dollars in the expense of operation. The credit balances created in favor of the Federal Reserve Banks with the several national banks would materially reduce the transfer of funds incident to the collection and clearance of checks. A

Federal Reserve Bank, for example, might check against a credit balance in a remote part of its district to pay a debit balance of another bank in that part of the district. The funds of the United States would be available in the parts of the country where they are most needed and a very much more scientific system could be worked out along these general lines than that now in force.

It may be possible that some slight amendment to the Federal Reserve Act would be necessary to authorize national banks to receive deposits for Federal Reserve Banks and to issue certificates in their name, but if the system is approved there should be little difficulty in procuring such an amendment, and I respectfully recommend that the question be taken up with the Secretary of the Treasury with the view of having the matter investigated and the details worked out for his consideration.

Respectfully,

M. C. ELLIOTT,

Counsel.

7/19/16.