FEDERAL RESERVE BOARD

WASHINGTON

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November 21, 1916.

My dear Mr.

On behalf of the Federal Reserve Board's Committee on Clearing, I want to ask you some questions and make some suggestions about progress in the clearing operations and what steps, if any, should be taken to promote the enterprise. It would appear that while the progress was very good in the first sixty days, we have now come to something rather like a standstill.

It appears, through the operation of rules adopted by banks in most of the clearing house cities, that the non-member banks and banks not agreeing to remit at par, are reaping practically the same benefit from the arrangement as those who are members and whose cash is invested in the Federal Reserve Banks. For example, a non-member bank can, if it cares to, operate through a member bank, get all its items on the banks that remit at par cleared through the Federal Reserve Bank at a nominal expense.

The customer is receiving very slight benefits from the introduction of the system. I have found, for example, in a number of the large cities no charge is made on the checks of customers, regardless of the banks upon whom drawn, while in other cases the same charges as were formerly made are in effect and no differential is made to the customer in favor of a check drawn on a member bank, or on a bank agreeing to remit at par through the Federal Reserve Bank.

I do not see how we are going to increase our clearing operations very materially, or add to our par list, unless we can give some inducement to the member bank; (1) for using our facilities; (2) to the State bank that remits at par over the non-member State bank that refuses to remit at par; and, (3) we will continue to get complaints from merchants, manufacturers and jobbers unless we can secure for them a substantial share of the advantages from the reduced cost of collections through Federal Reserve Banks.

At the present time Boston is collection for its members checks drawn on every bank in its own district. San Francisco is doing the same, though, in the case of San Francisco, the collection is made in some cases at considerable expense through the agency of express companies, or in such other way as may be necessary or expedient. The Federal Reserve Bank of San Francisco is thus rendering a very valuable service to its members, because it is taking from its members checks drawn on any city in the district and collects them as best it may. If, in doing this, it were to establish a differential rate, say $1\frac{1}{2}$¢ for checks on banks that remit at par and a charge sufficient to cover expense on checks drawn on banks not remitting at par, I think they would increase their par list rapidly and if, by the same token, you could induce your city bankers to establish a differential charge between checks collectable through the Federal Reserve Bank on a nominal charge and those not so collectable, you would rapidly add to your par list, by pointing out to the depositors the advantage of dealing with banks whose checks are collectable at par through the Federal Reserve Bank. The action of the Kansas City and Omaha banks, and the St. Paul and Minneapolis banks has been along this line, and has resulted in adding more banks to the par list than all the other Federal Reserve Banks combined.

Another suggestion which comes up for consideration on the recommendation of one of the Federal Reserve Banks is the right to pay a member bank a fee for collecting items drawn on non-member banks in its neighborhood. This suggestion was embodied in the original proposal made by the Clearing Committee to the Governors and it is believed to be absolutely sound in principle. Just what would be fair compensation in various circumstances and how it should be applied remains to be worked out. In cities big enough to maintain clearing houses there is no object in having such a rule, because the Federal Reserve Bank can operate through any member bank that is a member of the clearing system, but where we are asking a member bank to collect from non-member banks, a moderate compensation fee would certainly be entirely justifiable and would be one means of giving country member banks some reward for their membership in the Reserve System. The payment to a member bank of a small fee for collecting non-member bank items must not be confused, as some of the Governors have done, with the payment of an exchange charge to the remitting bank. Our whole collection plan is based on the proposition that a check is payable in cash at the counter of the bank upon which it is drawn. However, that check is presented, the bank paying the cash has no right to deduct anything from the face of the check. We pay the cost of remitting cash if cash is necessary, or we accept suitable exchange or offsetting items. If we ask Bank "A" to send its messenger to Bank "B", whether he be a mile off, or ten miles off, some fee for rendering this service and remitting the proceeds is certainly justifiable and proper and, in the opinion of the Clearing Committee, would go a long way toward rounding out our System.

If this idea, as above explained, were coupled with the San Francisco plan of accepting from member banks checks drawn on every bank in the district, whether that bank has assented to remit at par or not, it would make rapid strides toward the adoption of a universal clearing system. The customer of the bank would then sort his checks in two columns, in one column checks drawn on banks collectable at par through the Federal Reserve Bank; in the other column checks which can only be collected at more or less expense, and upon which some arbitrary fee of perhaps 1/8 or 1/10 might apply.

Your early consideration of all these suggestions will be very much appreciated and I may say that I am in hopes that you will come to the meeting of Governors in December with some concrete proposal calculated to meet the points herein offered and if there are objections to carrying out the suggestions made that you will offer some adequate substitute.

Yours very truly,

Chairman, Committee
on Clearing.