FEDERAL RESERVE BOARD

WASHINGTON

1024.

February 16, 1917.

Dear Sir:

The Board deems it advisable that the Federal reserve banks should understand clearly what they may and may not do in the way of rediscounts or loans based upon United States Government bonds or notes. For your information, therefore, a memorandum which has been prepared by counsel and which has been approved by the Board, is sent to you herewith, as follows:

Section 13 of the Federal Reserve Act provides two methods whereby Federal reserve banks may make advances to their member banks for the purpose of enabling them or their customers to carry or trade in bonds or notes of the United States.

Paragraph 2 of Section 13 provides that upon the endorsement of a member bank, a Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions, which may or may not be secured by staple agricultural products or other goods, wares or merchandise. The law then states that "such definition" of eligible paper shall not include notes, drafts, or bills of exchange drawn for the purpose of "carrying or trading in stocks, bonds or other investment securities <u>except bonds and notes of the Government of the United States.</u>"

This is equivalent to an affirmative declaration that a Federal reserve bank may discount a note, draft, or bill of exchange endorsed by a member bank which is issued or drawn for the purpose of carrying or trading in bonds or notes of the United States. This clause of Section 13, however, does not permit of the discount for a member bank of one of its own bills payable, since the requirement that the note or bill must be endorsed by a member bank precludes the possibility of applying this provision to the discount of anything but customers' paper.

The amendment to Section 13, approved September 7, 1916, provides on the other hand that a Federal reserve bank may make advances to its member banks on their promissory notes for a period not exceeding fifteen days, provided, such notes are secured by certain specified classes of paper or "by a deposit or pledge of bonds or notes of the United States." It is evident, therefore, that a member bank may borrow directly from its Federal reserve bank on the security of Government obligations, but not for a period longer than fifteen days.

Under the provisions of Section 14, subsection (b), Federal reserve banks are authorized "to buy and sell at home and abroad, bonds and notes of the United States" and under authority of this section member banks owning Government obligations may properly sell them to any Federal reserve bank desiring to make the purchase.

S U M M A R Y

I. Any member bank which has loaned money to any of its customers for the purpose of carrying or trading in bonds or notes of the United States, may rediscount with its Federal reserve bank the bill or note of its customer, provided, such bill or note

(a) Has a maturity at the time of discount of not more than ninety days, exclusive of days of grace;

(b) Has the endorsement of the member bank.

Such bill or note, however, need not necessarily be secured and need not be drawn for a commercial purpose other than for the purpose of carrying or trading in notes or bonds of the United States.

II. Any member bank which has itself purchased obligations of the United States may procure advances from its Federal reserve bank, for not exceeding fifteen days, on its own promissory note, provided, such note is secured by a deposit or pledge of bonds or notes of the United States.

III. Any member bank owning bonds or notes of the United States may, under authority of Section 14, subsection (b), sell such bonds or notes to any Federal reserve bank, desiring to make the purchase.

Very truly yours,

Governor.