FEDERAL RESERVE BOARD

WASHINGTON

X-325

August 11, 1917.

Dear Sir:-

The Board deems it advisable that there should be a thorough understanding on the part of the Federal reserve banks and of the member banks of its attitude in relation to the collection of "maturing notes and bills," and wishes to invite your attention to the distinction between the par clearing and collection of checks and drafts drawn on member banks and the collection of notes and drafts made by or drawn upon individuals, firms, or corporations other than banks.

Section 13 of the Federal Reserve Act, as amended by the Act approved June 21, 1917, provides in part that:

> "Provided, further, that nothing in this or any other section of this Act shall be construed as prohibiting a member or nonmember bank from making reasonable charges, to be determined and regulated by the Federal Reserve Board, but in no case to exceed 10 cents per $100 or fraction thereof, based on the total of checks and drafts presented at any one time, for collection or payment of checks and drafts and remission therefor by exchange or otherwise; but no such charges shall be made against the Federal reserve banks."

The question has been raised whether this provision of the law would prohibit a member bank from charging a Federal reserve bank for collecting and remitting for a note or bill of exchange forwarded to it by a Federal reserve bank for that purpose. In other words, does this provision of the law apply to promissory notes and bills of exchange as well as to checks and drafts on member banks? The Federal Reserve Act in several sections clearly distinguishes between "checks and drafts" on the one hand and "notes and bills" on the other. For instance, the first paragraph of Section 13 authorizes Federal reserve banks to receive from member banks deposits of "checks and drafts," without limiting the purpose for which the deposit must be made. The same paragraph authorizes a Federal reserve bank to receive "maturing notes and bills," but "for collection" only. So also, Section 16 of the Act requires a Federal reserve bank to receive deposits of "checks and drafts drawn upon any of its depositors," (i. e., upon member banks and upon banks carrying balances with Federal reserve banks), but nowhere is there any requirement that "maturing notes and bills"

must be received at par, and it is obvious that such items were eliminated for the reason that no bank can properly be forced to credit at par an unmatured or uncollected note or bill. Not being in the nature of a cash item, such an instrument is necessarily subject to a discount. In other words, Congress in this section distinguishes between the ordinary check and bank draft, and the note and bill of exchange.

With these lights before us, a proper construction of the so-called "Hardwick amendment" to Section 13 which in terms, provides that

> "nothing in the Act shall be construed as prohibiting a member or nonmember bank from making charges * * * for collection or payment of checks and drafts and remission therefor by exchange or otherwise, but no such charges shall be made against the Federal reserve banks"

must necessarily draw a distinction between checks and drafts (on banks) and promissory notes and bills of exchange. Both the wording of this amendment and the purposes for which it was enacted necessarily lead to the conclusion that it was not intended to prohibit a member bank from charging a Federal reserve bank for services rendered in collecting bills and notes which the Federal reserve bank sends to it for that purpose. The phrase, "but no such charges shall be made against the Federal reserve banks" is construed by the Board as being intended solely for the purpose of preserving the check clearing and collection system inaugurated by the various Federal reserve banks; and there was no intention, either express or implied, to prohibit member banks or nonmember banks from making reasonable charges against Federal reserve banks for services rendered in collecting maturing notes and bills.

The Board holds therefore, that charges for transactions of this kind may be made now with the same propriety as before the passage of the Act of June 21, 1917. Such charges would seem to be permissible upon the hypothesis that notes and bills thus sent to a member bank by the Federal reserve bank for collection, are not drawn on the member bank, but upon some third party; and it would be unreasonable and unfair to permit a Federal reserve bank to select any particular member or nonmember bank to act as its intermediary or agent for the purpose of collecting and remitting free of charge all of the notes and bills held by it for collection and payable in any particular city or locality. Such service must be performed by the member or nonmember bank only as a matter of

contract, and not because of any legal or moral obligation upon such bank to make collections gratis for the Federal reserve bank or for the banks for whom it acts as agent.

In the case of "checks and drafts drawn upon any of its depositors" (i. e., banks) however, the law provides that no charge for the service of collection, and payment and remission by exchange or otherwise, should be assessed against Federal reserve banks. The Board holds that the reason for this is that the Federal reserve banks are affording all member banks certain reciprocal advantages in the collection and clearance of checks, and because the Federal reserve banks are obligated to receive checks at par they may properly expect remission therefor on the same basis. In other words, the prohibition in the Hardwick amendment relating to the charges on the collection of checks and drafts on banks for Federal reserve banks, is merely an equalizing element in perfecting the check collection system, which must afford reciprocal privileges and advantages with the least possible expense to all concerned.

The paragraph of Section 16 which immediately follows the one which requires Federal reserve banks to receive on deposit checks at par, authorizes the Federal Reserve Board at its discretion, to exercise the functions of a clearing house for Federal reserve banks, or to designate a Federal reserve bank to exercise such functions, and to require each Federal reserve bank to exercise the functions of a clearing house for its member banks. In clearing house cities checks on member banks properly go to the clearing house, but promissory notes and drafts or bills of exchange payable by third parties, are not sent to the clearing house but are collected independently by the holding bank.

For these reasons the Federal Reserve Board is of the opinion that not only is it clear that the Hardwick amendment does not apply to the right of a member bank to charge the Federal reserve bank for the service of collecting notes and bills of exchange, but also that there is no sound reason or policy which would require that the Federal reserve banks should be immune from such a charge. While the Board must insist upon a strict compliance by the member banks with the law requiring par collection of checks for Federal reserve banks, it has no desire to deprive any bank of any compensation allowed by the law and to which the bank may be reasonably entitled. Because of competition, banks are performing many services free of charge which involve them in expense and

for which they are justly entitled to remuneration.

In the opinion of the Board, it should be the aim of the Federal reserve banks in developing plans for the collection of "maturing notes and bills," to offer efficient service, but they should be compensated and protected against any abuse or expense in performing this service, and this principle applies, of course, to member banks.

It seems that some apprehension exists on the part of many member banks that the clearing of checks at par is but a prelude to a requirement that they make no charge for checks and drafts received by them for deposit and credit, or for collection and remittance from others than a Federal reserve bank. It appears, however, that the provisions of the so-called Hardwick amendment clearly preserve the right of any member bank to make a reasonable charge against depositors or banks other than Federal reserve banks, not to exceed one-tenth of one per centum, for such services, the amount of such charge to be determined and regulated by the Federal Reserve Board.

The Board would request that this letter be brought to the attention of your directors at the next meeting, and you are at liberty to communicate the views of the Board to any of your member banks which may be interested.

Very truly yours,

Governor.