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ADDRESS REPLY TO  
FEDERAL RESERVE BOARD

December 20, 1918.

X-1322

SUBJECT: United States Securities Pledged  
with Federal Reserve Banks.

Dear Sir:

The Federal Reserve Board's attention has been called to the fact that Federal Reserve Banks

(1) In some instances have accepted Liberty Bonds or equities therein, from depositary banks as security for war loan deposits, when the bonds or equities were, in fact, the property of the customers of the depositary bank. In the absence of express authority from the customer to re-hypothecate such securities, a transaction of this kind is of very doubtful legality.

(2) Banking institutions in certain section of the country have accepted Liberty Bonds on deposit for their customers, agreeing to collect the interest for them and to return an equivalent amount of bonds upon demand. These bonds in some instances have been offered to Federal Reserve Banks as security for deposits or advances.

In the absence of express authority from the customer depositing such bonds, there is serious doubt of the right of the depositary bank to re-hypothecate or use these bonds, either as security for deposits or as collateral security for advances made.

Aside from the legal questions involved, the acceptance of borrowed bonds as a basis for loans or advances from the Federal Reserve Bank, has

a decided tendency to bring about undue inflation.

The Governors of the Federal Reserve Banks as chairmen or heads of the local Liberty Loan organizations, have more or less definite information in regard to the amount of bonds purchased by the depositary banks for their own account and the amount purchased for the account of customers. It is probable, therefore, that the Federal Reserve Banks would be charged with notice of the ownership of the bonds accepted either as collateral security for deposits or as collateral security for advances made by the Federal Reserve Banks, if any question should later arise as to the true ownership of the bonds in question.

This being true, it is important that every precaution should be taken to prevent Federal Reserve Banks from incurring any liability to the bond owners on account of transactions of this sort. It is accordingly suggested that in accepting United States bonds as security for deposits or as security for advances made to member banks, the Federal Reserve Bank should, in case of doubt, require the depositary bank or member bank to file a certificate of ownership of the bonds pledged or to furnish a copy of the agreement between the customer and the bank authorizing the hypothecation of the securities, or the Federal Reserve Bank might require all applications for rediscount or for advances and all pladge agreements used in connection with war loan deposits to show that all United States bonds offered as collateral security are the property of the bank or are used with the written consent of the owner.

Kindly acknowledge receipt.

Respectfully,

The Governor,  
Federal Reserve Bank,

Governor.