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ADDRESS REPLY TO
FEDERAL RESERVE BOARD

October 27, 1919.

X-1707

Subject: Eligibility for Rediscount
of Cotton Factors' Paper.

Dear Sir:

There is quoted below, for your information, the text of a letter recently addressed to one of the Federal Reserve Banks, in which the Board defines its view as to the eligibility of cotton factors' paper:

"The Federal Reserve Board has carefully considered the question whether cotton factors' paper may properly be considered eligible for re-discount as commercial paper within the meaning of Section 13 of the Federal Reserve Act. The Board in its consideration of this subject has examined the brief submitted by the directors of the Memphis Branch of the Federal Reserve Bank of St. Louis, together with the letters and statements of various other persons interested in the determination of the question.

"In view of the fact that it is apparent from all the evidence on hand that the circumstances and conditions under which so-called cotton factors' paper is issued vary so much in different cases, it is impossible to give any categorical answer to the question presented, or to make any general ruling that cotton factors' paper, as such, is eligible for rediscount.

"The Board is firmly of the opinion on the one hand that paper, the proceeds of which are used to lend to some third party, is finance paper rather than commercial paper and is, in consequence, ineligible for rediscount even though that third party may use the proceeds for a commercial purpose. On the other hand, the Board believes that any paper, the proceeds of which are used to purchase goods to sell to some third party, is eligible for rediscount as commercial paper within the meaning of Section 13. Whether or not a given transaction falls within one class or the other, is solely a question of fact for the determination of the Directors of the Federal Reserve Bank to which the paper is presented for rediscount. In other words, the mere fact that a borrower on a given note is a cotton factor, does not of itself render that note ineligible, since its eligibility is a matter to be determined by the use to which the proceeds of that particular note are put. If a cotton factor borrows on his own note to increase his capital for the purpose of lending to his customers, the note would come within the first class and would be ineligible, but if it can be determined that the proceeds of the note instead of being

loaned to a customer by the factor are used by the factor to purchase goods which are shipped to the customer and which are charged by the factor against the customer's account, then the note attains a commercial status because of the commercial purpose to which its proceeds are applied by the factor. In order to ascertain the necessary facts it may be proper for a Federal Reserve Bank to require statements or affidavits from the maker of the note as to the exact nature of the transaction out of which it arises. With these principles as a guide, the Federal Reserve Bank must determine the eligibility of any particular paper in the light of the circumstances in which it was issued, and its proceeds disposed of."

Very truly yours,

Governor.

Letter to Chairman of each bank.