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## FEDERAL RESERVE BOARD

ADDRESS REPLY TO  
 FEDERAL RESERVE BOARD

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November 29, 1919.

X-1738

Subject: Balances of Non-Member Clearing Banks.

Dear Sir:-

Some question has been raised as to the method of computing the amount and character of the balances to be maintained with their respective Federal Reserve Banks by non-member clearing banks, that is, banks which have made deposits with the Federal Reserve Banks for the purpose of exchange or collection under the provisions of Section 13 of the Federal Reserve Act.

On pages 617 and 618 of the August 1917 Bulletin there is published an opinion of counsel to the effect that the purpose of the proviso in the so-called Hardwick amendment to Section 13 is to afford protection to the Federal Reserve Banks against any possible loss resulting from clearing transactions with non-member banks and that the Federal Reserve Banks are therefore authorized to require and should require a clearing non-member bank to maintain a balance sufficient in the judgment of the officers of the Federal Reserve Bank to offset checks or other items drawn against the depositing bank and presented by the Federal Reserve Bank for payment as well as items received from the depositing bank.

There is quoted below for your information a letter addressed to one of the Federal Reserve Banks under date of October 29, 1919, which is not intended in any way to amend the opinion above referred to but which is merely for the purpose of defining, first, the amount that is necessary to constitute an "offset" for checks deposited by a non-member bank with the Federal Reserve Bank and still in the process of collection, and second, the character of the "balance sufficient" to make the offset.

"Dear Sir:-

"I have received your letter of October 21st, suggesting some modifications of the Board's attitude upon that portion of Section 13 of the Federal Reserve Act which refers to the clearing accounts of non-member banks.

"The language of Section 13, which is repeated in Regulation J, provides, in connection with the establishment of clearing accounts by non-member banks and trust companies that, 'such non-member bank or trust company maintain with the Federal Reserve Bank of its . .

district a balance sufficient to offset the items in transit held for its account by the Federal Reserve Bank.'

"Before discussing whether a 'balance' means a book balance or a collected balance, it would be well to throw some light upon the meaning of the word 'offset'. In cases where a non-member bank collects items through a Federal Reserve Bank and receives deferred credit only after the items have actually been collected, it is clear that no balance whatever is necessary to offset items in transit held for account of the non-member bank by the Federal Reserve Bank. The Board's construction of the word 'offset', therefore, is that it must apply to the labor performed and the expense incurred by the Federal Reserve Bank in collecting the items for the non-member bank. It seems, therefore, in determining what balance will be sufficient to offset items in transit held for account of a non-member bank by the Federal Reserve Bank where credit is not given until the items are actually collected consideration should be given to the average volume of collections made by the Federal Reserve Bank for the non-member bank and the proportion borne by such business to the total collection business of the Federal Reserve Bank. It will be found in many cases that the value of a small actual balance will be sufficient to compensate the Federal Reserve Bank for its work in handling collections for a non-member bank and that the amount of balance required will be less than the average daily volume of collections received from the non-member bank.

"While the Board has made no formal ruling covering its interpretation of the words 'a balance sufficient' it has, nevertheless, construed these words to mean a collected balance. If a non-member bank should be permitted to maintain only an uncollected balance against its items in process of collection by the Federal Reserve Bank, it is likely that the Federal Reserve Bank would be left most of the time with only an uncollected balance on its books, representing no actual funds available to the end of compensating itself for the work and expense involved. No commercial bank, having regard for good banking practice, would tolerate such a situation. If the privilege you suggest were accorded to member banks, the Federal Reserve System might at times have no usable funds, and the granting of it to clearing non-member banks would make it to the interest of a state bank to become a clearing non-member rather than a regular member. Such a bank could, in various ways, do its borrowing through its correspondents, and at the same time use the collection facilities of the Federal Reserve System without contributing one penny to the upkeep of that System.

"This problem would appear to solve itself, if the bank commissioners of the various states, in designating the Federal Reserve Bank as a reserve agent for state banks, should stipulate ( as they probably will and as I think they should), that the required reserve must be carried in collected funds as in the case of national banks.

"The opening of clearing accounts by non-member banks will undoubtedly accrue to the advantage of the Federal Reserve System, and will materially add to the service it renders. Success in attracting such accounts will, as you state, facilitate the acquisition of par points, and such acquisition of par points will encourage member banks to send all miscellaneous items direct to the Federal Reserve Banks and branches, with the idea of checking against excess reserves in favor of correspondents with whom interest-bearing balances are desired. In addition, the opening of clearing accounts by non-member banks will also very likely give impetus to the proper routing of items, because these banks, if the volume of their business justifies, can be authorized to send items direct to the Federal Reserve Banks and branches for the credit of their city correspondent. It seems to me, however, that the Board should continue for the present, to construe the words 'balance sufficient' to mean a collected balance.

"Your information as to the action which will be taken by the state bank commissioners in your district is very interesting. It would be excellent if these commissioners, in designating the Federal Reserve Bank as a reserve agent for state banks, could be prevailed upon to make the conditions and requirements covering such reserve balances uniform. I shall be pleased to have you keep me posted on this phase of the situation as it develops."

As indicated above where a non-member bank clears items through a Federal Reserve Bank and receives a credit only after the items have been collected, it is evident that no balance whatever is necessary to offset items in transit in order to protect the Federal Reserve Bank against any possible loss resulting from the transaction. The Board has ruled therefore that in such a case the reserve bank might require the non-member bank to maintain a balance sufficient to offset the expense incurred by the Federal Reserve Bank in making the collections. It should be noted, however, that this should not in any way interfere with the calculation of the amount of deposit which must be maintained in accordance with the opinion published in the Bulletin in order to protect the Federal Reserve Bank against any possible loss in the case of items drawn against the non-member bank which are being collected through the Federal Reserve Bank.

Very truly yours,

Governor.

To Governors and Chairmen of all F.R. Banks.