

January 20, 1920

Memorandum for  
Governor Harding

Subject: Preferential rates of dis-  
count on member bank notes.

Dear Governor Harding:

You have asked the following question:- If the Federal Reserve Board approves a Federal Reserve Bank's recommendation of preferential rates of discount for member bank notes secured by certificates of indebtedness of the United States, or by Liberty Bonds or Victory Notes, may the Federal Reserve Bank make advances at those rates only when the certificates of indebtedness, bonds or notes pledged as security are actually owned by the member bank procuring the advance and only when the Government deposit of such bank, if any, at the time that the advance is made is also secured respectively by certificates of indebtedness, Liberty Bonds or Victory Notes actually owned by the bank.

There is no doubt that a Federal Reserve Bank may establish and the Federal Reserve Board may approve preferential rates of discount upon member bank notes secured by certificates of indebtedness, Liberty Bonds or Victory Notes; that has already been done in previous instances. There is also no doubt that the exercise of the power conferred upon a Federal Reserve Bank to make advances upon member bank notes secured by certificates of indebtedness, Liberty Bonds or Victory Notes is purely optional with the Federal Reserve Bank and not mandatory. The Federal Reserve Board has frequently had occasion to rule that the word "may" as used in the Federal Reserve Act in contradistinction to the word "shall" is permissive, and that powers conferred upon reserve banks by that word, may or may not be exercised in the discretion of the Board of directors of the Federal Reserve Bank. In the exercise of that discretion, however, the board of directors is required by the terms of Section 4 of the Federal Reserve Act to -

"administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks and shall, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks."

From a legal standpoint, therefore, it is clear that if a Federal Reserve Bank establishes and the Federal Reserve Board approves preferential rates upon member bank notes secured by certificates of indebtedness, Liberty Bonds or Victory Notes, the reserve bank may, as a matter of administration, refuse to make an advance on such notes unless the certificates of indebtedness, bonds or notes pledged as security are actually owned by the member bank and unless the Government deposit of such bank, if any, at the time such advance is made is also secured respectively by certificates of indebtedness, Liberty Bonds or Victory Notes actually owned by it.

The Federal Reserve Board in transmitting its approval of a rate may, of course, advise the reserve bank of the nature of its powers referred to above. An expression of the Board's opinion in that respect may be helpful to the reserve bank in the effective administration of its preferential rates.

Respectfully,

GEORGE L. HARRISON.

General Counsel.