FEDERAL RESERVE BOARD

WASHINGTON

April 12,1920.
X-1896

Dear Congressman:-

The situation regarding the Federal Reserve clearing system can be summed up in a very few words. There are certain clauses in Sections 13 and 16 of the Federal Reserve Act which seem to require the Federal Reserve Board to establish a system for the clearing by the Federal Reserve Banks of all checks payable upon presentation within their respective districts regardless of whether the checks are drawn upon member or non-member banks. It appears also that the Federal Reserve Banks are required to receive these checks when tendered them for deposit by member banks, at par - that is, without making any deduction from the face amount for collection or exchange charges. Section 13 empowers the Federal Reserve Board to fix reasonable charges, not to exceed 10¢ per $100, which may be made by one bank against another bank for remitting in exchange or otherwise for checks received for collection, but there is a proviso that "no such charges shall be made against Federal Reserve Banks."

Upon being asked for an opinion, the Attorney General of the United States has construed this provision literally and has advised the Board that Federal Reserve Banks cannot lawfully pay any charge or fee to a bank for remitting to the Federal Reserve Bank for checks drawn upon the payer bank which have been sent to it by the Federal Reserve Bank for payment in exchange or otherwise.

It is evident therefore that a Federal Reserve Bank receiving checks on non-member banks for deposit must proceed to collect these checks and that if the banks upon which they are drawn will not remit at par the Federal Reserve Bank is obliged to provide itself with some other means of making the collection. The Federal Reserve Banks therefore have called the attention of non-member banks to these provisions of law and have stated that stamped envelopes will be sent in each case to the remitting bank in order that there may be no actual expense incurred by the payer bank in making the remittance and that if it is more convenient remittance may be made in currency at the expense of the Federal Reserve Bank. All non-member banks have been advised that

if they do not care to remit to the Federal Reserve Banks at par, collection will be made through some outside agency by having the checks presented at the bank counters for payment.

If this is coercion as contended by your constituent it is unavoidable, for regardless of the question as to whether Congress has the right to legislate in any way that results in the diminution of the profits of state banks, it clearly has the power to legislate in matters relating to the manner in which the Federal Reserve Banks shall operate. The Board's view therefore is that Congress (1) has directed all banks, non-members as well as members, not to make exchange charges against Federal Reserve Banks, (2) has directed the Federal Reserve Banks to receive on deposit at par any checks and drafts which are payable on presentation, and (3) has directed the Federal Reserve Banks not to pay any exchange charges to banks in making these collections.

Whether Congress has the constitutional right to enact a law prohibiting a Federal Reserve Bank from paying exchange to a non-member bank on checks drawn upon the non-member bank by its own depositors may be argued to be a question of law which should be determined ultimately by the courts. If it is desired to test the constitutionality of the law, it appears that the banks which question its validity should initiate proceedings rather than the Federal Reserve Board. If, on the other hand, they should concede that Congress has the right to legislate in the manner it has done but believe that the law is oppressive, unjust or unwise, it would appear that they should appeal to Congress with the view of having the objectionable features of the Act stricken out or modified. Here again it would seem that the initiative should be taken by the banks which feel themselves aggrieved in the matter. If these banks, although entertaining doubts as to the validity of the law, should feel that because of the length of time necessarily involved in obtaining a judicial and final interpretation it is undesirable to litigate, then again it would seem that recourse should be had to the more direct method of appealing to Congress. In that case, however, it would seem that the banks would put themselves in a more consistent attitude if they would not attempt to obstruct the operation of the law as it now stands pending a final determination of policy by Congress.

The Board holds the further view, however, that if non-member banks be no longer required to remit at par, member banks also should be relieved from such an obligation, for the member banks are supporting the Federal Reserve System and it would be unfair to deprive them of opportunities for profit which are given to non-members. This, of course, raises a question as to the conflict of the interest of the business community and the general public on the one hand, and the banks on the other. If you should be interested in a further consideration of this phase of the matter, I would suggest that you read the enclosure, which is a copy of a letter which the Board sent a few days ago to a United States Senator in answer to some inquiries made by one of his constituents.

Very truly yours,

Enclosure.

W.P.G. HARDING,
Governor.

NOTE:
The enclosure referred to is Mimeo. X-1881, which was sent you with Mimeo. X-1884, of April 5, 1920.