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FEDERAL RESERVE BOARD

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November 1, 1920.

X-2044

Subject: Acceptances drawn by dealers engaged
 in the export and domestic sale of the
 same class of goods.

Dear Sir:-

The Federal Reserve Board has received an inquiry as to whether bankers' acceptances, drawn by dealers engaged in both export and domestic trade under a certain form of contract with the accepting banks, are eligible for rediscount and purchase by Federal Reserve Banks under the Board's new regulations of the Series of 1920. The form of contract was prepared some time ago to comply with the requirements of an opinion of the Board's Counsel dated April 1, 1918. In that opinion published on page 314 of the April 1918 Bulletin and on page 438 of the May 1918 Bulletin, it was suggested that drafts, drawn by a dealer purchasing the same class of goods both for export and domestic sale and accepted by a bank to finance the purchase and sale of the goods to be exported, might be considered eligible bankers' acceptances if the dealer's contract with the accepting bank provided -

"(a) that he has entered into a contract for the export of the goods of a fixed amount; (b) that the total amount of drafts drawn by him under the credit opened to finance the export of such goods shall at no time exceed the aggregate amount of the import or export transactions contracted for and in process of execution; (c) that the proceeds of drafts drawn against the accepting bank under this credit are to be used in connection with the export contracts referred to, and that the proceeds of the sale of the goods exported will be applied in payment of the acceptances unless the dealer has in the meantime placed the bank in funds to meet them at maturity or has secured such acceptances by shipping documents, warehouse receipts, or other similar document conveying or securing title to readily marketable staples."

This suggestion was further commented upon in an opinion published on page 439 of the May 1918 Bulletin. As a result of these opinions the form of contract in question was submitted to and approved by the Federal Reserve Board containing the provisions suggested in the above quotation.

This form is now used, the Board understands, by a number of concerns, engaged in both foreign and domestic trade, when arranging for acceptance credits with their banks.

In the cases under consideration the drafts are drawn to finance the purchase or production of goods to be exported, and the actual export shipment of the goods has not actually occurred at the time of acceptance. Under the Board's Regulations A and B, Series of 1920, bankers' acceptances so drawn in export or import transactions are eligible for rediscount or purchase by Federal Reserve Banks only when they comply with the requirements of Regulation A, Section B, Subdivision (b) (1)

"that there be in existence a specific and bona fide contract providing for the exportation or importation of such goods at or within a specified and reasonable time and that the customer agree that the accepting bank will be furnished in due course with shipping documents covering such goods or with exchange arising out of the transaction being financed by the credit."

It is apparent that a contract of the kind suggested in the opinion of April 1st does not comply with these requirements.

Under the terms of the Federal Reserve Act the Federal Reserve Board is vested with broad discretion in the matter of regulating the rediscounts and open market purchases of Federal Reserve Banks. The Board's ruling, incorporated in the published opinion of April 1, 1918, was made during the war and at a time when it was necessary to facilitate in every way the exportation of goods essential to the prosecution of the war. The opinion permitted the use of bankers' acceptances under circumstances which would not justify their use at the present time. The Board's regulations of the Series of 1920 which have just been issued, supersede all previous rulings which are inconsistent with them and make acceptances drawn under the form of contract suggested in the opinion of April 1, 1918, ineligible for rediscount or purchase.

If dealers purchasing or producing the same class of goods both for export and domestic sale wish to finance their export transactions by means of eligible bankers' acceptances it will be necessary that their contracts with the accepting banks shall contain different provisions than those suggested in the opinion of April 1, 1918. The Board now suggests that the contracts between such dealers and their accepting banks contain the following provisions, (a) that the dealer has entered into contracts providing for the exportation of goods of a specified amount within a specified and reasonable time; (b) that the total amount of drafts drawn by the dealer under credits opened to finance the exportation of such goods shall at no time exceed the aggregate amount of the export transactions contracted for and in process of execution; (c) that the proceeds of drafts drawn against the accepting bank under this credit will be used to consummate the export contracts referred to, that the dealer will furnish in due course to the accepting bank shipping documents covering such goods, and that the proceeds of the sale of the goods exported will be applied in liquidation of the acceptance credit.

The furnishing of "exchange arising out of the transaction being financed by the credit" is intended as an alternative to the furnishing of shipping documents only in import transactions so that this phrase, which appears in Regulation A, may be disregarded in considering export transactions.

Under the Regulations of 1920 acceptances drawn to finance the purchase or production of goods under contract for export are eligible for rediscount or purchase only when the customer definitely agrees that the accepting bank will be furnished in due course with shipping documents covering such goods. Such acceptances will no longer be eligible, therefore, if the customer is given the option to furnish warehouse receipts or similar documents, and thus to change the nature of the acceptances by converting them from acceptances based upon export transactions into acceptances based upon domestic transactions.

Yours very truly,

Governor.

To Governors and Federal Reserve Agents.