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ADDRESS REPLY TO
 FEDERAL RESERVE BOARD

November 22, 1920.

X-2068

Subject: Acceptances against Shipping Documents.

Dear Sir:

The Federal Reserve Board has been asked to rule upon the eligibility of bankers' acceptances created under the following circumstances:

Cotton seed oil is sold and shipped by a mill to a refiner. The mill draws a sight draft upon the refiner and attaches the bill of lading covering the cotton seed oil shipped. Upon receipt of the sight draft with bill of lading attached, the refiner pays the sight draft and retains the bill of lading. The refiner desires to draw ninety day drafts for acceptance by his bank, the bill of lading to be attached to the draft at the time of acceptance but to be returned to the refiner immediately thereafter. The facts which have been presented to the Board do not indicate how long a period of time it takes for the completion of the shipment from the mill to the refiner, but it is to be inferred that the shipment will be concluded shortly after the drawing of the drafts by the refiner. In fact it is urged that the drafts must be drawn for ninety days because it will require at least that time before the refiner can refine the cotton seed oil, and re-ship the finished product and receive payment therefor.

The Federal Reserve Board is of the opinion that drafts drawn under these or similar circumstances are not eligible for rediscount by Federal Reserve Banks.

The Board has heretofore ruled that drafts drawn by the purchaser of goods and secured at the time of acceptance by bills of lading covering the goods bought are not eligible unless the proceeds are to be used to pay for the goods. (Federal Reserve Bulletin May 1917, page 380; Federal Reserve Bulletin January 1920, page 66). Under the facts which have been presented to the Board in the present case, it is not clear whether the refiner is to use the proceeds of the bankers' acceptance to pay the mill for the cotton seed oil covered by the bill of lading. If not, the acceptance would be ineligible upon this ground.

Furthermore, even though it should appear that the refiner is to use the proceeds of the draft to pay for the cotton seed oil purchased, the circumstances would not, in the Board's opinion, justify the issuance of a ninety day acceptance credit, since it is apparent that the credit is desired for the purpose of adding to the working capital of the borrower rather than to finance the shipment of goods during the period that the

shipment is continuing. A credit for such a purpose should, of course, be granted upon the borrower's promissory note rather than by means of bankers' acceptances.

In the ruling in the January 1920 Bulletin it was said with reference to certain renewal acceptances "the spirit of the law does not contemplate that acceptances based upon the domestic shipment of goods shall be used as a cloak to finance the carrying of those goods throughout the process of manufacture into finished products". The principle there stated is equally applicable to original acceptances based upon the domestic shipment of goods.

Regulation A of the Board's Regulations, Series of 1920, provides in Section B, Subdivision (c) (2) that -

"Although a Federal Reserve Bank may rediscount an acceptance having a maturity at the time of rediscount of not more than three months, exclusive of days of grace, it may decline to rediscount any acceptance the maturity of which is in excess of the actual or customary period of credit required to finance the underlying transaction or which is in excess of any period reasonably necessary to finance such transaction".

Where bankers' acceptances are drawn against bills of lading, the underlying transaction is, of course, the domestic shipment of the goods covered by the bill of lading. The period during which the acceptances are to run should, therefore, have some relation to the period of time actually required for the shipment. The acceptance of drafts secured by bills of lading for the primary purpose of providing the borrower with working capital during the period required to manufacture and resell the goods covered by the bills of lading is an abuse of the domestic acceptance privilege which should be carefully guarded against: and Federal Reserve Banks should decline to rediscount or purchase acceptances made for such purpose.

Very truly yours,

Governor.

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