

## FEDERAL RESERVE BOARD

WASHINGTON

X-3115

May 13, 1921.

**SUBJECT:** Purchases of Acceptances from  
Accepting Banks.

Dear Sir:

There is enclosed for your information copy of a letter addressed by the Board to Hon. H. L. Myers, United States Senator, in response to a communication from him relative to complaint of the Montana Wool Growers Association as to the policy said to have been adopted by a Federal Reserve Bank with respect to the purchase of acceptances drawn against domestic shipments of wool when offered by the accepting banks.

Very truly yours,

G o v e r n o r .

TO CHAIRMEN ALL FEDERAL RESERVE BANKS.

X-3115a

COPY

May 10, 1921.

Hon. H. L. Myers,  
United States Senate,  
Washington, D. C.

My dear Senator:

I am writing with further reference to your letter of April 30, 1920, enclosing a telegram from the Montana Wool Growers Association which, as stated in my letter of May 2, was referred by the Federal Reserve Board to its Counsel.

The telegram in question refers to my letter of June 22, 1920, quoting a statement authorized by the Federal Reserve Board to the effect that a wool grower may draw a draft upon his bank secured by shipping documents covering wool shipped to some point of distribution, and that the draft after acceptance and when endorsed by a member bank will be eligible for rediscount or purchase by Federal Reserve Banks, provided, it has a maturity of not in excess of ninety days at the time of rediscount or purchase. The telegram then states that the Federal Reserve Bank of Minneapolis "advises that if borrowing individual already owes bank ten per cent limit drafts of such borrower not eligible for discount unless bearing endorsement of member bank other than accepting bank", and suggests that this requirement is a hardship upon the wool growers and should be modified.

Federal Reserve Banks may, under the terms of the first paragraph of Section 14, purchase bankers' acceptances in the open market "with or without the endorsement of a member bank", and such purchases may be made from any individuals, corporations, or banks. It is clear that under the terms of this paragraph a Federal Reserve Bank technically has authority to purchase from the drawer or even from the accepting bank a bankers' acceptance which bears no endorsement other than that of the accepting bank.

The normal and desirable practice, however, is for the drawer to discount acceptances with some bank other than the accepting bank, rather than for the accepting bank to

discount the acceptances. In view, however, of the fact that the acceptance business is comparatively new in this country, and in view of the consequent lack of an adequate open market for bankers' acceptances in some districts, it has seemed best for some of the Federal Reserve Banks to purchase acceptances direct from the accepting banks, in the hope that the proper use of, and an active market for, bankers' acceptances may thereby be encouraged.

It is apparent that the endorsement of the accepting bank adds no strength to the instrument since the accepting bank is already liable primarily as its acceptor, and the Federal Reserve Board in February, 1920, instructed Federal Reserve Banks that all purchases, direct from the accepting bank, of bankers' acceptances bearing no member bank endorsement other than that of the accepting bank should be made at the prevailing rate for commercial paper rather than at the preferential rate applicable to bankers' acceptances as such.

The telegram of the Montana Wool Growers Association refers to a ten per cent limitation, and I assume that this reference is to the limitation contained in the third paragraph of Section 13 of the Federal Reserve Act which provides that no Federal Reserve Bank shall discount for any member bank an aggregate of notes, drafts and bills bearing the signature or endorsement of any one borrower in excess of ten per cent of the member bank's capital and surplus, this restriction not applying to the discount of bills of exchange drawn in good faith against actually existing values. This limitation does not apply to open market purchases made under authority of Section 14, so that it does not prevent a Federal Reserve Bank from purchasing an unendorsed bankers' acceptance from the accepting member bank, even though the Federal Reserve Bank already holds under discount from that member bank paper representing loans in an amount equal to ten per cent of the member bank's capital and surplus made by the member bank to the drawer of the acceptance.

It should be remembered, however, that there is no obligation upon a Federal Reserve Bank to purchase paper offered to it for rediscount or purchase even though the paper is technically eligible as a matter of law. The Federal Reserve Banks have discretionary power, just like any other bank, to decline to purchase paper whenever for any reason that course seems advisable. In view of the fact that an acceptance endorsed only by the accepting bank is supported by the credit of only two parties, and in this respect is like

a customer's note endorsed by the bank, the Federal Reserve Board feels that a Federal Reserve Bank is justified in limiting its open market purchases of bankers' acceptances of this character so that it will at no time hold under rediscount or purchase from one member bank an aggregate amount in excess of ten per cent of the member bank's capital and surplus of (1) notes, drafts and bills of any one borrower, and (2) bankers' acceptances made by the member bank for the same borrower, but bearing no endorsement other than that of the accepting bank. The Board has, however, issued no ruling upon this point and for the time being at least is willing to leave the matter to the sound banking discretion of the officers of the Federal Reserve Banks.

The foregoing, I think, covers the various points of law raised by the inquiry of the Montana Wool Growers Association. As I have already said, whether or not and upon what conditions a Federal Reserve Bank will rediscount or purchase an eligible acceptance offered to it, are questions for the determination of the proper officers of the Federal Reserve Bank in the exercise of their sound banking judgment in the light of all the circumstances of the particular case. I am quite confident that the Federal Reserve Bank of Minneapolis in making the statement attributed to it did not intend to construe the law but merely intended to state its own judgment as to the propriety of purchasing acceptances under the conditions stated.

For your information there is enclosed herewith a copy of my letter of June 22, 1920, which is referred to in the telegram of the Montana Wool Growers Association from which I think you will see that the Board fully appreciates the situation in which the wool growers find themselves and wishes to do what it can consistent with law and sound principles for the relief of that situation.

Yours very truly,

G o v e r n o r .

Enclosure.