

FEDERAL RESERVE BOARD

WASHINGTON

X-3175
July 27, 1921.

SUBJECT: Bankers' acceptances drawn by cooperative marketing associations against warehouse receipts covering agricultural commodities

Dear Sir:

For your information, there is enclosed herewith a copy of a ruling recently issued by the Federal Reserve Board with respect to bankers' acceptances drawn by cooperative marketing associations against warehouse receipts covering non-perishable agricultural commodities.

Yours very truly,

(Enclosure)

G o v e r n o r .

TO GOVERNORS AND F. R. AGENTS.

X-3175a
July 20, 1921.

SUBJECT: Bankers' acceptances drawn by cooperative marketing associations against warehouse receipts covering agricultural commodities.

Dear Sir:

The Federal Reserve Board has considered the question presented by you as to the eligibility of bankers' acceptances drawn by cooperative marketing associations against warehouse receipts covering non-perishable agricultural commodities. The Board understands the facts upon which your request for a ruling is predicated to be as follows:

Each association is a corporation organized without capital, and its members consist exclusively of producers of the particular crop which the association is organized to market. Each producer, as a condition of membership in the association, signs a standard form of agreement under the terms of which he agrees to sell and deliver his crop to the association. This agreement provides in substance that title to the commodity so delivered shall pass to the association at the time of delivery, that the transaction between the producer and the association is a sale, and that the association shall have absolute control over the commodities delivered with the unqualified right to re-sell or hypothecate. The price at which the commodity is sold by the producer to the association is not fixed at the time of that sale, but the agreement provides that all of the commodities delivered to the association shall be pooled according to grades and re-sold, and the association agrees to pay to each producer the average price realized by the association upon the re-sale of the commodity in the pool to which the producer has contributed, less a proportionate part of the association's expenses. The commodities are to be stored in warehouses independent of the association and negotiable warehouse receipts issued therefor. The question presented to the Federal Reserve Board for a ruling is whether drafts drawn by such associations against these warehouse receipts will be eligible for acceptance by member banks and whether after acceptance the drafts will be eligible for rediscount by Federal Reserve Banks.

Section 13 of the Federal Reserve Act provides that:

"Any Federal Reserve Bank may discount acceptances of the kinds hereinafter described, which have a maturity at the time of discount of not more than three months sight, exclusive of days of grace, which are endorsed by at least one member bank."

"Any member bank may accept drafts of bills of exchange drawn upon it having not more than six months sight to run, exclusive of days of grace, * * * which grow out of transactions involving the domestic shipment of goods, provided shipping documents conveying or securing title are attached at the time of acceptance; or which are secured at the time of acceptance by warehouse receipt or other such document conveying or securing title covering readily marketable staples."

The Federal Reserve Board is of the opinion that a draft drawn by an association operating under the plan described above is eligible for acceptance by member banks when secured at the time of acceptance by a warehouse receipt of the kind referred to in the above statement of facts, and that after acceptance such a draft will be eligible for rediscount by Federal Reserve Banks provided it complies in all respects with the regulations of the Federal Reserve Board.

The law requires that a warehouse receipt, in order to be the basis of an eligible bankers' acceptance, shall be a document "conveying or securing title covering readily marketable staples." There is no question but that the warehouse receipts described in the above statement of facts comply with this requirement of the law, since according to that statement, they are negotiable warehouse receipts covering readily marketable staples, the absolute and unqualified ownership of which has been conveyed to the association. The Board has not, however, undertaken to examine the forms of agreements entered into between the associations in question and their members but assumes that these agreements have the legal effect which they are stated to have. If, in a particular case, any question should arise as to the proper construction of these or other agreements, that question would be primarily for the determination of the banks against which the drafts are drawn and the Federal Reserve Banks to which the acceptances are offered for rediscount.

In your letter you state that "The acceptances will probably be ninety day acceptances with an agreement for one or possibly two renewals, depending upon the commodity." A member bank cannot accept an original or renewal draft unless it is drawn in compliance with the terms of Section 13 of the Federal Reserve Act and consequently a member bank cannot agree unconditionally to accept a renewal draft but can only agree to accept in the event that the renewal draft is eligible for acceptance under the terms of the law.

Furthermore, the Board has ruled that where it is known that a six months credit is required it is improper to draw two ninety day acceptances in order to make them at all times eligible for rediscount by Federal Reserve Banks, and that in such a case the original acceptance should be drawn for the full six months period. If, however, at the time the original acceptance is drawn it is reasonable to anticipate that the transaction will be liquidated within a period of three

months, a ninety day acceptance may be issued in the first instance, and a renewal acceptance may be issued at the end of the ninety day period, if, because of abnormal or unforeseen developments, liquidation has not been completed at that time. The Board understands that it is reasonable to anticipate that the sale and liquidation of the commodities held by the associations at any given time will be completed within ninety days from that time. If this is so, there is no objection to the issuance of ninety day acceptances in the first instance.

There is enclosed herewith a copy of the Board's regulations. Section B of Regulation A deals with the eligibility of bankers' acceptances for rediscount by Federal Reserve Banks and your particular attention is directed to subdivision (b)(3) of that section. This subdivision relates to acceptances against warehouse receipts and other similar documents covering readily marketable staples, and prescribes under what circumstances it is proper for the accepting bank to release the original documents.

It should be understood, of course, that a Federal Reserve Bank is under no obligation to rediscount an acceptance offered to it, even though the acceptance is technically eligible for rediscount. It is the function of a Federal Reserve Bank, when eligible paper is offered to it, to determine in the exercise of its sound discretion whether the paper is desirable as an investment for the bank.

Yours very truly,

(Signed) W. P. G. HARDING,

G o v e r n o r .