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FEDERAL RESERVE BANK
OF DALLAS

April 16, 1924.

Federal Reserve Board,
Washington, D. C.Attention: Mr. Wyatt,
General Counsel.

Gentlemen:

I have your telegram of April 15th, with reference to our objection to the proviso in old subdivision 3, new subdivision 4 of Section 5, Regulation "J". The proviso in question is as follows:

"Provided, however, that the Federal Reserve Bank reserves the right to charge such items to the reserve account or clearing account of such bank at any time when the Federal Reserve Bank deems it necessary to do so."

The language employed in the old subdivision 3, which preceded the proviso in question, constituted general authority from the Federal Reserve Board for Federal Reserve Banks to follow either one of two general methods of collection; that is, each Federal Reserve Bank could, at its option, forward checks for collection and remittance or for collection and credit.

If the first method were adopted, then the Federal Reserve Bank would look wholly to the remittance sent it for payment of the items involved. This remittance could, of course, be in the form of a draft on the bank's reserve account or on other acceptable drawees, and the Federal Reserve Bank would, under its duties as agent having authority to receive these remittance drafts, be liable only for due diligence in the presentation and collection of the remittance draft sent it. It is very desirable where this plan is followed, that the Federal Reserve Bank undertake no duty to its principal, further than to use ordinary care in the collection of the remittance draft sent it in payment of the checks.

If the second method were followed, then the Federal Reserve Bank could, by proper authorization, charge the account of the bank to which items are sent, even though Regulation "J" did not contain the proviso above quoted.

In connection with banks following the collection and remittance plan, the proviso under discussion might easily be construed by the courts to place upon a Federal Reserve Bank the duty of charging the bank's account with the amount of outstanding cash letters whenever such Reserve Bank has the slightest information which would lead it to believe that the ultimate collection of the remittance draft is in anywise doubtful. A state of facts might frequently arise when a Federal Reserve Bank would fail to

charge the account of a bank with the outstanding cash letters, and before the remittance draft was collected, the bank to which the items were sent failed. Under such circumstances, our principal would contend that we had full authority to charge the account of the bank to which we sent the items for collection, and had we taken advantage of the authority conferred upon us, the items would have been collected; and thus it would be contended that we were negligent in failing to charge the account. We would, therefore, always be confronted with a serious question in the collection of checks from extended member banks.

Banks following the collection and remittance plan would never have occasion to charge the account of the bank to which items were sent unless they were specifically authorized to do so. The proviso, therefore, could benefit only those banks following the collection and credit plan. I am firmly of the opinion that the proviso does not in any manner strengthen the position of Federal Reserve Banks following the latter plan, because as a matter of law they would have the right to charge the account of the bank to which items were sent.

We would have no objection to the proviso if it applied only to Federal Reserve Banks following the collection and credit plan. However, as it read in the old subdivision 3, it applied both to the banks following the collection and remittance plan, and to those following the collection and credit plan.

For the reasons hereinabove stated, it is our opinion that old subdivision 3, as changed and now incorporated in new subdivision 4, gives to any Federal Reserve Bank all the latitude which it could possibly desire, and at the same time does not contain the embarrassing features.

Very truly yours,

(signed) E. B. Stroud, Jr.

Office Counsel.

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