(COPY) X-4149

Comments on Complaint of Pascagoula National Bank against the Federal Reserve Bank of Atlanta, et. al. in the United States District Court for the Northern District of Georgia.

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Without attempting to discuss plaintiff's preliminary technical allegations necessary for the identification of parties, jurisdiction, etc., the following comments will deal only with certain paragraphs of the allegations having reference to the merits of the case.

Paragraph 12. The statement as to the checks which Federal Reserve Banks may receive is not correct. Section 13 as originally enacted read in part as follows:

> "Any Federal Reserve Bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national-bank notes, Federal reserve notes, or checks and drafts upon solvent member banks, payable upon presentation; or, solely for exchange purposes, may receive from other Federal reserve banks deposits of current funds in lawful money, national-bank notes, or checks and drafts upon solvent member or other Federal reserve banks, payable upon presentation."

The Act of September 7, 1916 amended the foregoing part of the Section to read as follows:

> "Any Federal Reserve Bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national bank notes, Federal reserve notes, or checks and drafts, payable upon presentation, and also, for collection, maturing bills: or, solely for purposes of exchange or of collection, may receive from other Federal reserve banks deposits of current funds in lawful money, national bank notes, or checks upon other Federal reserve banks, and checks and drafts, payable upon presentation within its district, and maturing bills payable within its district."

On June 21, 1917 this part of the Section was again amended by inserting the words "notes and" after the word "maturing" in the sixth line and in twelfth line as written above and by

adding the following which constitutes the so-called Hardwick Amendment:

> "; or, solely, for the purposes of exchange or of collection, may receive from any non-member bank or trust company deposits of current funds in lawful money, national-bank notes, Federal reserve notes, checks and drafts payable upon presentation, or maturing notes and bills: Provided, such non-member bank or trust company maintains with the Federal reserve bank of its district a balance sufficient to offset the items in transit held for its account by the Federal reserve bank; Provided, further, That nothing in this or any other Section of this Act shall be construed as prohibiting a member or non-member bank from making reasonable charges, to be determined and regulated by the Federal Reserve Board, but in no case to exceed ten cents per $100 or fraction thereof, based on the total of checks and drafts presented at any one time, for collection or payment of checks and drafts and remission therefor by exchange or otherwise; but no such charges shall be made against the Federal reserve banks."

The part of the section dealing with checks has not been amended since June 21, 1917 and now reads as indicated above.

It will be noted that there is no limit so far as place of payment is concerned as to the checks and drafts which a Federal reserve bank may receive from its member banks and that there is likewise no limit as regards the place of payment of checks and drafts which may be received from non-member clearing banks. The only place where the words "within its district" occur is in that part of the Section dealing with checks and drafts which may be received from other Federal reserve banks for purposes of exchange or of collection.

The Section as it now reads confers upon any Federal reserve bank the right to receipt deposits of checks and drafts payable upon presentation as follows:

1. From member banks, checks and drafts payable anywhere.

2. From other Federal reserve banks checks upon other Federal reserve banks and checks and drafts payable within the district of the receiving Federal reserve bank when received for purposes of exchange or of collection.

3. From any non-member clearing bank or trust company checks and drafts payable anywhere.

Paragraph 18. There is nothing in the Federal Reserve Act to indicate that the prohibition of payment of exchange charges by Federal reserve banks was designed solely for the protection of the revenues of the Federal reserve banks. There is, on the other hand, ample indication in the history of check collection in the United States both before the Federal Reserve Act was passed and during the operation of the Federal reserve banks prior to the amendment of June 21, 1917, to indicate that Congress intended to free any check which could be collected through the Federal reserve banks from these so-called exchange charges. The right was conferred upon Federal reserve banks to receive deposits of checks from member banks as well as from non-member banks under certain conditions and it must be supposed that Congress, not having indicated otherwise, expected that Federal reserve banks would receive such deposits in the way that they are generally received by banks and that ordinarily, therefore, the Federal reserve bank might be acting as an agent in the collection of such checks. If this conclusion is correct, Congress must have intended member banks which collect checks through the Federal reserve banks to get the benefit of exemption from exchange charges, ir-

respective of any question of agency. This view is supported by the fact that so far as checks drawn on member banks are concerned, the Federal reserve banks must, under Section 16, receive such checks at par and if this requirement is to be given the indicated effect the Federal reserve banks cannot assess the charges on such checks against the depositing banks. The view that the agency function of the Federal reserve bank in the collection of checks is not a determining test in deciding whether exchange may be charged by the drawee banks is further supported by the fact that the same Act (June 21, 1917) which inserted prohibition against such charges in Section 13 also amended Section 19, dealing with reserves, in such a way as to indicate that the Federal reserve bank cannot count as reserve for a member checks deposited by that member bank but not yet collected. See opinion of Counsel, Mr. Weed, dated August 8, 1923. In other words, by preventing the credit of checks to the reserve account before the proceeds are obtained, the amendment of Section 19 in the Act of June 21, 1917 in effect practically amended Section 13 so that checks received from member banks are received for collection, that is, Federal reserve banks act as agents in obtaining payment of checks.

Paragraph 19. The provision in Section 16 that every Federal reserve bank must "receive on deposit at par from member banks .... checks and drafts drawn upon any of its depositors ....." is not a requirement that Federal reserve banks must give immediate credit in the depositing bank's reserve account or that the

Federal reserve bank is under an obligation to pay the amount of the checks deposited or any part of the deposit as soon as the depositing member bank sees fit to draw a check against it. Plaintiff's allegation in this paragraph is evidently based upon an erroneous interpretation of the words "deposit" or "on deposit" as applied to ordinary banking practice and as used in the Federal Reserve Act. So far as the deposit of money in an open account is concerned, it is undoubtedly true that the depositor has a right to draw a check against the deposit at any time he may elect, but this may or may not be true of checks or other negotiable instruments deposited, depending on the circumstances. A check may be deposited in a bank in such a way as to constitute a sale of it or it may be deposited for collection. As stated by Tiffany on "Banks and Banking", when a negotiable instrument is endorsed generally, or, being payable to bearer, is delivered to and deposited with a bank, the transaction may be a sale of the paper or a deposit for collection, according to the agreement of the parties. The agreement of the parties may be evidenced by general notices which are printed on the pass books or deposit slips or otherwise brought home to the depositor, or an agreement may be presumed from general usages obtaining in a locality or by statute. It is true that some courts hold that where a different understanding does not affirmatively appear, the title to negotiable instruments deposited in a bank in the ordinary course of business immediately passes to the bank, which becomes a debtor to the depositor for

the amount, but even where there is no affirmative understanding as to agency or as to the deposit for collection, other courts have held that the practice which is followed by some banks of crediting deposits of checks at once to the depositor's account or by allowing him to draw against such deposits, is a mere gratuitous privilege, as stated by Tiffany, the privilege being also extended where the paper is endorsed "for collection" as well as where it is endorsed without restriction, the bank being able to revoke the privilege at any time and, consequently, unless it affirmatively appears that the credit is irrevocable, the beneficiary ownership of the paper is not transferred and the transaction constitutes a deposit for collection.

The words "deposit" or "on deposit" as generally used, therefore, are capable of a broad interpretation and so far as the Federal Reserve Act is concerned, Congress has indicated that the broader interpretation must apply. For example: Section 13 refers in several instances to deposits of checks and drafts for purposes of exchange or of collection and also indicates that maturing notes and bills may be deposits for collection. All of which indicates that the framers of the Federal Reserve Act had in mind that a deposit may consist of items upon which immediate availability is deferred, and a Federal reserve bank, therefore, has the right to defer immediate credit in the reserve account until the proceeds are obtained. One must go even further than that. The Federal Reserve Act, prior to the amendment of June 21, 1917,

recognized a right to defer credit but since the amendment of June 21, 1917, it imposes a positive duty upon Federal reserve banks to defer credit for checks deposited until the proceeds are obtained, because the only balance of a member bank in a Federal reserve bank which can be checked against is the required balance carried as a reserve, and that balance, under Section 19 as amended June 21, 1917, must be "an actual net balance". An actual net balance means a collected balance and not a balance created by giving immediate credit for checks not yet collected. See opinion of Counsel, Mr. Weed, dated August 8, 1923. The Act of June 21, 1917, constitutes, therefore, in effect an amendment of that part of Section 13 dealing with the deposit of checks, as already stated, and also that part of Section 16 dealing with the same subject.

Paragraph 21. Plaintiff's allegation that since the Federal reserve bank defers credit the drawee banks are entitled to charge exchange, is evidently based upon the test of agency which plaintiff seeks to establish, because the further allegation is made that if immediate credit is given, title being thereby vested in the Federal reserve bank receiving the deposit, the right to charge exchange against the Federal reserve bank would be destroyed by the prohibition in Section 13. As pointed out elsewhere, the mere difference between principal and agency does not affect the matter. Section 13 makes a positive declaration that "no such charges shall be made against the Federal reserve banks", and there is no qualification to that prohibition expressed or implied anywhere in the Act.

As already related, Congress evidently intended that any bank which clears checks through the Federal reserve bank should get the benefit of this exemption from exchange charges. In fact it is this reciprocal benefit in clearance that is one of the considerations in requiring member banks, at any rate, to pay at par for checks drawn upon themselves. This consideration of the mutual benefit of par clearance was evidently in the mind of the Supreme Court in its decision in the Farmers and Merchants National Bank of Monroe, North Carolina against the Federal Reserve Bank of Richmond, because the Court in speaking of the amendment of September, 1916 and of the provisions of the later amendment (June 21, 1917) by which non-member banks were given the right to clear through Federal reserve banks, uses the following language:

> "It was recognized that non-members were left free to refuse assent to par clearance ... Reserve banks could not under the then law, make collections for non-members. It was believed that if Congress would grant Federal reserve banks permission to make collection also for non-members, the Board could offer to all banks inducements adequate to secure their consent to par clearance. A further amendment to Section 13 was thereupon secured by the Act of June 21, 1917 ...",

(the Supreme Court thereupon quoting that part of Section 13 which permits the collection of checks for non-member banks). Undoubtedly, the inducement which the Supreme Court had in mind was the right to have checks which banks might deposit, collected without payment of exchange. It should be added that Section 16 compels the reception of certain checks at par from member banks. It should also be added that neither Section 13 nor Section 16 either expressly or impliedly imposes any duty upon Federal reserve

banks to act as the agent of a drawee bank, from which it has received payment for checks, in collecting from the banks depositing those checks, the drawee bank's charges for remission of the proceeds.

Paragraph 22. It seems highly improbable that a member bank could successfully attack the constitutionality of the prohibition of Section 13 against the payment of exchange charges by Federal reserve banks. With respect to national banks it may be said that as long as such a bank continues to operate under a national charter it must accept any reasonable regulations imposed by act of Congress. It has, however, an alternative; it may relinquish its charter and operate under such state charter as it may obtain. A state bank likewise has an alternative; it may abstain from or withdraw from membership in the Federal Reserve System. This prohibition is a condition of membership imposed upon all member banks, national banks having had a certain period within which to choose whether they should become members, and if membership is retained or accepted, it would seem to be binding and the conditions having been assumed or accepted voluntarily by member banks, it is difficult to see that the prohibition is open to attack on the ground of constitutionality.

Paragraph 24. The Supreme Court decisions quoted dealt with the matter of exchange charges by non-member banks and one of them had reference to exchange charges by a non-member bank in a state which by statute specifically permitted a drawee bank to pay by draft

for checks presented through a Federal reserve bank. The question of the right of a Federal reserve bank to defer credit on checks received from member banks, was, therefore, not raised.

Neither of the Supreme Court decisions questions the right of a Federal reserve bank to collect checks from member banks without the payment of exchange charges. In American Bank & Trust Company against the Federal Reserve Bank of Atlanta which dealt only with the question of the right of a Federal reserve bank to collect checks payable in its own district by presenting checks over the counter of the drawee bank, the Supreme Court of the United States ruled as follows:

> "Federal reserve banks are, thus, authorized by Congress to collect for other reserve banks, for members, and for affiliated non-members checks on any bank within their respective districts, if the check is payable on presentation and can in fact be collected consistently with the legal rights of the drawee without paying an exchange charge. Within these limits Federal reserve banks have ordinarily the same right to present a check to the drawee bank for payment over the counter as any other bank, state or national, would have".

Part of plaintiff's complaint in this allegation appears to be that the par list is still circulated and still drawing to the Federal reserve banks for collection a large volume of checks that could otherwise be presented in other ways, but the Supreme Court in the same decision just mentioned, indicates that this is not a proper cause of complaint against Federal reserve banks, the Court having taken cognizance of the fact that largely because of the superior facilities of the Federal reserve banks,

most checks on country banks are now routed through the reserve banks and the Court having stated that "Country banks are not entitled to protection against legitimate competition. Their loss here shown is of the kind to which business concerns are commonly subjected when improved facilities are introduced by others or, a more efficient competitor enters the field". Even in the case of a North Carolina bank where the state statute permits the drawee bank to remit by draft on a correspondent, the Supreme Court, while denying the obligation of the Federal reserve bank to collect checks from non-member banks, admits that they may do so. The Court used the following language:

> "But neither Section 13 nor any other provision of the Federal Reserve Act imposes upon reserve banks any obligation to receive checks for collection. The Act merely confers authority to do so".

Paragraph 25. The allegation that "Federal reserve banks are not authorized to receive for collection any check or draft except from their respective members or depositing non-members and no check or draft that is not payable on presentation within the district of the Federal reserve bank receiving it", is not supported by the provisions of Section 13. Those provisions are quoted in the foregoing comments upon paragraph 12 of the allegations. The three groups of checks which Federal reserve banks may receive are summarized in the comments on that paragraph. With regard to checks from member banks and non-member clearing banks, there is no distinction as to the place where a check or draft may be payable. Moreover, Section 13 does not itself restrict

the purposes for which deposits of checks may be made by member banks, although, as stated elsewhere, the amendment of June 21, 1917 to Section 19 does in effect constitute a restriction that such checks are received for collection.

General. Though it is not so explicitly stated, the basis of plaintiff's contention that it is entitled to charge exchange against the Federal reserve bank, appears to consist of the argument that there is a conflict between the right of drawee banks to collect exchange recognized by the Federal Reserve Act, and the prohibition against the payment of such charges by the Federal reserve banks, which can be reconciled only in the way evidently advanced by plaintiff, the determining principle obviously being whether the Federal reserve bank acts as an agent in the collection of checks deposited with it. The question of agency has been discussed elsewhere in these comments. As a matter of fact, there is no conflict between the various provisions of the Federal Reserve Act dealing with exchange charges. Section 13 specifies that member and non-member banks are not prohibited from making reasonable charges within certain maximum limits, for the collection or payment of checks and drafts and the remission therefor. At the same time that this right is recognized, the explicit direction is made that no charges shall be made against the Federal reserve banks. The Supreme Court of the United States in Farmers & Merchants Bank of Monroe, N.C., vs. Federal Reserve Bank of Richmond, recognizes the difference between a charge for collection and

par clearance in the following language:

> "Par clearance does not mean that the payee of a check who deposits it with his bank for collection will be credited in his account with the face of the check if it is collected. His bank may, despite par clearance, make a charge to him for its service in collecting the check from the drawee bank. It may make such a charge although both it and the drawee bank are members of the Federal Reserve System; and some third bank which aids in the process of collection may likewise make a charge for the service it renders. Such a collection charge may be made not only to member banks by member banks, national or state, but it may be made to member banks also by the Federal reserve banks for the services which the latter render. The collection charge is expressly provided for in Section 16 of the Federal Reserve Act which declares that 'the Federal Reserve Board shall by rule fix the charges to be collected by the member banks from its patrons whose checks are cleared through the Federal reserve bank and the charge which may be imposed for the service of clearing or collection rendered by the Federal Reserve Bank'. Par clearance refers to a wholly different matter. It deals not with charges for collection but with charges incident to paying. It deals with exchange".

Any member bank dealing with other member banks or with non-member banks may make charges for collection or payment of checks and the remission therefor. It simply cannot make such charges against the Federal reserve bank. It should be further noted that Section 16 provides that the charges to be collected by member banks when checks are cleared through the Federal reserve bank, are to be collected <u>from the patrons</u> of the member banks, the language used being as follows:

> "The Federal Reserve Board shall, by rule, fix the charges to be collected by the member bank(s) <u>from its patrons whose checks are cleared through the Federal reserve bank</u> ... ".

There is, therefore, no conflict in the provisions of the Federal Reserve Act. If the drawee bank deals direct with other banks

it may collect exchange; if it deals direct with the Federal reserve bank, it may not collect exchange, but in that case it profits from the right to clear checks itself through the Federal reserve bank and also is permitted by the Federal Reserve Act to collect from its patrons such charges for their checks which are cleared through the Federal reserve bank, as the Federal Reserve Board may sanction.

C O P Y

X-4149(a)

HERRICK, SMITH, DONALD & FARLEY

BOSTON

August 8, 1924.

Honorable W. P. G. Harding,
Federal Reserve Bank,
Boston, Mass.

My dear Governor Harding:

You have asked my opinion as to whether as a matter of law a Federal Reserve Bank has any authority to give immediate credit on checks deposited with it for collection.

So far as member banks are concerned, this question necessarily involves the question of reserve requirements under Section 19 of the Federal Reserve Act. In my opinion a "reserve balance" required by Section 19 and which is defined as an "actual net balance" cannot include uncollected checks, and hence a Federal Reserve Bank has no authority to grant immediate credit on checks deposited with it and thereby give member banks the benefit of uncollected items in transit in computing reserve balances.

My reasons are as follows: Prior to the adoption of the amendment of June 21, 1917, Section 19 provided in substance as follows:

> "**********Every subscribing member bank shall establish and maintain reserves as follows:
>
> (a) A bank not in a reserve or central reserve city ********** shall hold and maintain reserves equal to twelve per centum of the aggregate amount of its demand deposits, and five per centum of its time deposits as follows:
>
> In its vaults for a period of thirty-six months after said date 5/12 thereof and permanently thereafter 4/12.

> In the Federal reserve bank of its district, for a period of twelve months after said date, 2/12, and for each succeeding six months an additional 1/12, until 5/12 have been so deposited, which shall be the amount permanently required".

It is unnecessary for the purposes of this opinion to quote in their entirety the somewhat elaborate provisions of Section 19 as originally drawn. It is sufficient to note that a member bank was required to hold and maintain certain "reserves" and that a portion of those reserves might be "in the Federal Reserve Bank", the portions in the Federal Reserve Banks to increase until the final amounts "have been so deposited". Thus amounts deposited in the Reserve Banks counted as reserves. It is to be noted that there was nothing specific as to whether these reserve deposits might or might not include checks which had been deposited but which had not been collected.

After the amendment adopted on June 21, 1917, Section 19 provided in substance as follows:

> "Every bank, banking association, or trust company which is or which becomes a member of any Federal Reserve Bank shall establish and maintain reserve balances with its Federal Reserve Bank as follows:
>
> (a) If not in a reserve or central reserve city ******** it shall hold and maintain with the Federal Reserve Bank of its district an actual net balance equal to not less than seven per centum *********".

It is unnecessary for the purposes of this opinion to quote the other provisions of Section 19 relating to reserves. The words "actual net balance" appear in the amendment of June 21, 1917 for the first time and should be carefully noted. What do these words mean? Clearly to my mind the words "actual" and "net" qualify and limit the word "balance", and quite apart from any light which may be thrown on their interpretation by reference to congressional debates or banking usage I should construe these words to exclude checks in the process of collection. However, I believe the history of the Legislation and banking

usage assist materially in their interpretation.

The proposal to amend the reserve requirements of Section 19 emanated from the Federal Reserve Board and in particular the words "actual net balance" seem to have originated with the Board. The statement which the Board made to the Committees of Congress in proposing the amendment in question is therefore pertinent. This statement appears in the February Bulletin of 1917 and reads in part as follows:

> "A minimum amount of currency that the member banks should be required to keep in their vaults is, therefore, prescribed. The amount suggested is 5 per cent of the demand deposits, so that the total requirements - cash and reserve - will remain practically unchanged. While the effect of some of the proposed changes will be to reduce somewhat the reserve requirements, the reserves will be increased by the abrogation of the practice hitherto observed of counting items in transit or "float" as reserve. The permission given member banks to use their own discretion as to the character of currency in their vaults, will enable them to release the gold they now hold, with the important result that the substitution of Federal Reserve notes for gold and gold certificates will be facilitated by this change in the law. Without some such change member banks will continue to ask for gold certificates in small denominations, because as long as they must have gold or lawful money to count as reserve it would be impossible for the banks to exchange them for Federal Reserve notes".

The above statement is in no(way)ambiguous and it is perfectly clear that in proposing the amendment to Section 19 the Federal Reserve Board intended to eliminate items in transit or "float", or in other words, the Federal Reserve Board intended to preclude the possibility of giving immediate credit on deposited checks in computing reserve balances.

The debates in Congress when the amendment to Section 19 was before the House of Representatives for consideration as H. R. 3675 are enlightening. Representative McFadden offered an amendment reducing the 7% reserve as contained in H. R. 3673 to 5%. Representative McFadden made the following comments, indicating that the proposed law, if enacted, would eliminate from the

reserve required to be maintained the "float" or uncollected items:

"Mr. McFadden. Mr. Chairman, this amendment proposes to reduce the legal requirements of the reserves of country banks from 7 to 5 per cent, as proposed in this Federal Reserve Amendment, but it is a well-known fact that while under the old law the legal reserve of 12 per cent applied to country banks, those banks, notwithstanding this fact, are keeping an average reserve of about 27 per cent. The country banks have never confined themselves to the legal requirements. Under these Federal reserve amendments as now proposed they will be compelled not only to keep all the reserves they now keep in the Federal Reserve Banks, but to increase them 2 per cent, or from 5 per cent to 7 per cent - and this must be a net balance of 7 per cent - whereas present requirements are a gross requirement. That is to say, the banks must carry the float amounting on the average to $1\frac{3}{4}$ per cent, being the checks in process of collection - so, therefore, the banks must carry $8\frac{3}{4}$ instead of 7 per cent.

"Mr. Cannon. Will the gentleman yield for a question?

"Mr. McFadden. Yes, I will.

"Mr. Cannon. Does the gentleman say that the country banks voluntarily keep 27 per cent reserve with the regional banks under the Federal Reserve Act?

"Mr. McFadden. Oh, not at all.

"Mr. Cannon. With their correspondents?

"Mr. McFadden. With the city correspondents of the bank and the regional banks combined.

"Mr. Cannon. Upon which they get 2 per cent interest?

"Mr. McFadden. That is one point I was coming to. The city correspondent banks pay them interest usually at the rate of 2 per cent, but the regional banks pay no interest. That is one of the reasons for my amendment reducing this requirement to 5 per cent.

"Mr. Cannon. And they get no interest from the Federal Reserve Banks?

"Mr. McFadden. No; as a matter of fact, their combined reserves today are about 27 per cent. They are permitted under the present law to keep a small portion of that with other banks in reserve cities, and under this law, if adopted, there will be a complete

mobilization of all reserves into the 12 regional reserve banks immeditately. Now, the purpose of this amendment is to permit these country banks to keep a portion of their reserves with other than Federal reserve banks and thus receive more compensation in the way of interest and other emoluments, such as services which are known only to the country banks. These city banks perform many forms of services for the country banks and are repaid by a compensating balance from the country banks. I might add here that in the Senate a bill has been reported from the Senate Banking and Currency Committee in which they have provided that the reserves of the country be fixed at 6 per cent.

"So that this amendment of mine would be 1 per cent lower than the Senate amendment. When you consider that this is a net reserve, and that the banks must carry the float or the checks in transit, and that amounts to on the average $1\frac{3}{4}$ per cent the country over, if you fix the required reserve at 7 per cent it means the banks must carry actually $8\frac{3}{4}$ per cent reserve to meet the legal requirements; whereas if you make the legal requirements 5 per cent and then add the float or checks in process of collection, amounting to $1\frac{3}{4}$ per cent, you then have the correct statement of what will then be required of the country banks - namely, $6\frac{3}{4}$ per cent under my amendment or $8\frac{3}{4}$ per cent under the proposed amendment of the Federal Reserve Board."

It seems to me from the above that it may be stated without fear of contradiction that Congress adopted the amendment of June 21, 1917 with full and complete understanding that the words "actual net balance" eliminated uncollected checks.

I have made inquiry of the officers of two of the largest banks in Boston as to whether in banking circles there is any common usage of terms so as to indicate what a "net balance" or an "actual net balance" might mean as distinguished from a "balance". I am informed that it is customary among banks, in computing the balances of their depositors, to make a very marked distinction between ledger balances and net or collected balances. I find that for the purpose of computing interest and for other purposes, it is common practice among bankers to refer to balances and net balances, meaning by net balances the balances of their depositors after eliminating uncollected items. I was

informed by one banker that "net balance" might in some cases be used by a commercial bank to mean the balance established after giving effect to amounts due to and from other banks. Nevertheless he felt that the term "net" or "actual net" balance as commonly used in banking circles would be interpreted to eliminate uncollected items or "float".

Thus, in addition to the light which is obtained from the debates in Congress, I think we may fairly say that the term "net balance" or "actual balance" as commonly used in banking circles would be construed to eliminate the "float".

As above stated, so far as member banks are concerned, the question of immediate credit necessarily involves the question of reserve requirements. I believe this requires no argument. As bearing on this point, however, the following provision contained in Section 19 is interesting;

> "The required balance carried by a member bank with a Federal Reserve Bank may, under regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities; provided, however, etc".

The words "required balance" clearly refer to reserve balances and reserve balances clearly refer to an "actual net balance". In other words, a member bank may draw checks against its actual net balance by virtue of the above provision, and by implication no other balance which is not an actual net balance is available to be checked against. It is interesting to compare the provision quoted above with the provision contained in Section 19 of the Federal Reserve Act prior to the amendment of June 21, 1917. Prior to the amendment, Section 19 contained a similar provision, but it was provided;

"The reserve carried by a member bank with a Federal Reserve Bank may ******** be checked against ********"

In other words, it would seem that in adopting the amendment of June 21, 1917, it was the intention of Congress not only to eliminate the "float" as counting in computing a reserve balance, but also to eliminate the power of a member bank to check against any balance which included the "float". In other words, the amendment of June 21, 1917, seems to be consistent throughout.

Section 13 of the Federal Reserve Act provides that a Federal Reserve Bank may receive from its member banks and from the United States deposits of checks and drafts payable on presentation, or solely for purposes of exchange or collection may receive from other Federal Reserve Banks deposits of checks upon other Federal Reserve Banks and checks and drafts payable on presentation within its district, or solely for purposes of exchange and collection may receive from any non-member bank or trust company deposits of checks and drafts payable upon presentation, provided such non-member bank or trust company maintains with the Federal Reserve Bank of its district a balance sufficient to offset the items in transit held for its account by the Federal Reserve Bank.

In reading Section 13, it should be noted that a non-member bank is required to maintain a balance sufficient to offset items in transit. The words used are not "net balance" or "actual net balance", but rather a "balance sufficient to offset items in transit". It seems to me that this provision regarding non-member banks has nothing to do with the present discussion. A non-member bank is not required to carry reserves in the Federal Reserve Bank. A non-member bank is only required to carry a balance which (presumably in the discretion of the Reserve Bank) must be sufficient to offset items in transit. Apart from this provision regarding non-member

banks, I find nothing in Section 13 which could be construed to require or authorize a Federal Reserve Bank to give immediate credit on account of checks deposited.

Section 16 provides that every Federal Reserve Bank shall receive on deposit at par from member banks or from Federal Reserve Banks checks or drafts drawn upon any of its depositors, and, when remitted by a Federal Reserve Bank, checks and drafts drawn by any depositor in any other Federal Reserve Bank or member bank upon funds to the credit of said depositor in said Reserve Bank or member bank. Although this provision of Section 16 would seem to require a Federal Reserve Bank to receive on deposit under certain circumstances checks and drafts, nevertheless I see nothing in this Section which would require or authorize a Federal Reserve Bank to give immediate credit on uncollected checks.

The effect of giving immediate credit on an uncollected check must necessarily be in the nature of making an advance to the depositing bank prior to the collection of the item. It seems to me that the elaborate provisions contained in the Federal Reserve Act regarding the discount of paper and the loaning to member banks on collateral notes preclude the idea of a Reserve Bank being authorized to make advances on uncollected items.

Thus, on the whole, as previously stated, it seems to me that the question of giving immediate credit necessarily involves the question of reserve requirements, and on the question of reserve requirements I think clearly that, as a matter of law, actual net balances mean balances after eliminating the "float" or uncollected items.

Very truly yours,

(Signed) A. H. WEED

AHW/KEO