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# FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO  
THE FEDERAL RESERVE BOARD

X-4813

March 22, 1927

SUBJECT: Topic for Governors' Conference.

Dear Sir:

The Federal Reserve Board has voted to place upon the program of the next conference of Governors for their consideration the question whether notes held by a member bank bearing the endorsement of officers of nonmember banks are eligible for rediscount at Federal reserve banks. This question was the subject of the Board's letter of February 17, 1927, X-4794. A copy of this letter together with copies of the replies thereto are enclosed herewith for your information.

Very truly yours,

Walter L. Eddy,  
Secretary.

Enclosures.

TO GOVERNORS OF ALL FEDERAL RESERVE BANKS.

FEDERAL RESERVE BOARD

X-4794

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WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO  
THE FEDERAL RESERVE BOARD

February 17, 1927.

Dear Sir:

The Board has been asked by one of the Federal reserve banks to rule upon the question whether certain notes held by a member bank bearing the endorsement of officers of nonmember banks are eligible for rediscount at Federal reserve banks. It appears that the member bank in question solicits loans through officers of its correspondent nonmember banks. The notes are made payable to the local bank officer and are endorsed by him to the member bank which allows him part of the interest on the loan in payment for his services. The name of the nonmember bank does not appear on the notes either as payee or as endorser.

Before ruling upon the question whether notes of this kind should be considered eligible or desirable for rediscount, the Board wishes to be fully informed as to the extent and prevalence of the practice of making loans in this way. You are accordingly requested to advise the Board whether notes originating in the manner described or under similar circumstances have ever been presented to your bank for rediscount and if so, whether or not they were rediscounted. The Board would also be glad to be advised as to the extent to which practices of this kind prevail in your Federal Reserve District.

Very truly yours,

D. R. Crissinger  
Governor.

TO GOVERNORS OF ALL F. R. BANKS EXCEPT KANSAS CITY.

COPY

X-4813-a

FEDERAL RESERVE BANK  
OF BOSTON

February 19, 1927.

Dear Sir:

Receipt is acknowledged of your circular letter of February 17, X-4794, and in reply I would say that no instance such as that referred to has ever come to the attention of this bank and, as far as we know, there is no practice of this kind existing in this district.

Should any note such as described in your letter be offered us for rediscount, we would, before considering the application, ask counsel for his opinion as to whether the transaction involves any violation of paragraph (c) of Section 22 of the Federal Reserve Act.

Very truly yours,

(s) W. P. G. Harding,

Governor.

Hon. D. R. Crissinger, Governor,  
Federal Reserve Board,  
Washington, D. C.

C O P Y

X-4813-b.

## FEDERAL RESERVE BANK OF NEW YORK

February 25, 1927.

Sirs:

In reply to your letter of February 17 (X-4794), we do not recall any case in which notes bearing the endorsements of officers of non-member banks have been offered us for rediscount by member banks. We are quite certain that no such practice as that described in your letter exists or has existed in this district.

Very truly yours,

(Signed) L. F. SAILER

Deputy Governor.

Federal Reserve Board,

Washington, D. C.

C O P Y

X-4813-c

FEDERAL RESERVE BANK OF PHILADELPHIA

February 19, 1927.

Dear Governor Crissinger:

In reply to your letter X-4794, I am writing to inform you that notes negotiated in the manner described by you have never been presented to this bank for rediscount and we have never found a practice of this kind in this district.

Very truly yours,

(s) W. H. Hutt,

Deputy Governor.

Hon. D. R. Crissinger,  
Governor, Federal Reserve Board,  
Washington, D. C.

X-4813-d.

C O P Y

FEDERAL RESERVE BANK OF CLEVELAND.

February 23, 1927.

Mr. D. R. Crissinger, Governor,  
Federal Reserve Board,  
Washington, D. C.

Dear Governor Crissinger:

Reference is made to the Board's letter X-4794, dated February 17, on the subject of the eligibility for rediscount at a Federal Reserve Bank of notes held by member banks bearing the endorsement of officers of non-member banks.

We have not had any paper of that kind offered to us for rediscount or as collateral.

Very truly yours,

(Signed) E. R. FANCHER

Governor.

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(COPY)  
FEDERAL RESERVE BANK OF RICHMOND

X-4813-e

February 21, 1927

Federal Reserve Board,  
Washington, D. C.

Gentlemen:

We have received and considered the Board's letter X-4794, under date of February 17, in which the Board expressed the wish to be informed as to the extent and prevalence of the practice with certain member banks of soliciting loans through its correspondent non-member banks and obtaining paper bearing the endorsement of officers of such nonmember banks.

To our knowledge, we have no such paper, and if such paper had come to us with the knowledge, we should have made most careful inquiry into the circumstances, since the practice, in our judgment, appears one to be condemned whether the paper may or may not be technically eligible for rediscount at Federal Reserve Banks.

Very truly yours,

(Signed) Geo. J. Seay,

Governor.

C O P Y

X-4813-f

F E D E R A L   R E S E R V E   B A N K  
O F   A T L A N T A

February 28, 1927.

Mr. D. R. Crissinger, Governor,  
Federal Reserve Board,  
Washington, D. C.

Dear Sir: -

Reference is made to Board Letter  
X-4794 under date of February 17th, regarding the  
solicitation through officers of correspondent non-  
member banks of loans by member banks, etc.

To the best of our knowledge no notes  
of this character have been offered to the parent bank  
or our New Orleans Branch, and should it be ascertained  
that such paper was offered to us it would be our policy  
to disapprove such items.

We do not think that the practice referred  
to in your letter is prevalent in this district, however,  
this is merely an expression of opinion as we have no  
first hand information.

Yours very truly,

(s) M. B. Wellborn,

Governor.



(COPY)

## FEDERAL RESERVE BANK OF CHICAGO

X-4813-g

February 24, 1927

Federal Reserve Board,

Washington, D. C.

Dear Sirs:           Attention: Honorable D. R. Crissinger,  
  Governor.

In further reference to your letter X-4794, dated February 17th, and in which letter reference is made to a case wherein a certain member bank solicits loans through officers of its correspondent non-member banks, involving notes made payable to the local bank officer and endorsed by him to the member bank, you ask for advice on two points as follows:

1. As to whether notes originating in the manner described, or under similar circumstances, have ever been presented to this bank for rediscount and if so, whether or not they were rediscounted.

In response I am pleased to advise you that we are unable to find any cases wherein notes of the class referred to, or of similar character, have been offered to us for rediscount.

2. The Board also inquires as to the extent to which practices of this kind prevail in this district.

We are not aware of the prevalence of such practices, and since the receipt of your letter have carefully reviewed the examiners' reports on approximately twenty-five member banks whose relations with their country correspondents might have led to such practice, but find no evidence of its existence.

Very truly yours,

(Signed) J. B. McDougal  
Governor.

C O P Y

X-4813-h

F E D E R A L   R E S E R V E   B A N K  
O F  
S T .   L O U I S

February 25, 1927.

Dear Governor Crissinger:

Replying to your letter of the 17th, X-4794, you are informed that no notes originating in the manner described or under similar circumstances have ever been presented to this bank for re-discount. We do not believe practices of the kind described prevail at all in this District.

Our Memphis Branch has had one or two notes offered to it which did bear evidence on their face that they were either acquired from a non-member bank or were taken indirectly thru a non-member bank as an accommodation. In each such case, after an investigation, the notes were taken up by the member bank re-discounting them.

Very truly yours,

(s) O. M. Attebery,

Deputy Governor.

Federal Reserve Board,  
Washington, D. C.

Attention: Governor Crissinger.

C O P Y

X-4813-i.

## FEDERAL RESERVE BANK OF MINNEAPOLIS.

February 24, 1927.

Hon. D. R. Crissinger, Governor,  
Federal Reserve Board,  
Washington, D. C.

Dear Governor Crissinger:

This will acknowledge receipt of your letter (X4794).

Since 1923 we have not rediscounted nor have there been offered to us any notes such as described in your letter. Previous to 1923 when we were authorized by the Board to discount paper originating in non member banks, we had a few notes offered to us bearing the endorsement of individuals associated with non member banks, and did discount such notes. We, however, gave but little consideration to such endorsements. In other words, we looked to the maker rather than the endorser. In doing so, we reasoned that if a note was eligible and desirable, the fact that an individual had endorsed or guaranteed the paper, could in no way affect its eligibility.

Yours respectfully,

(Signed) R. A. YOUNG

Governor.

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(COPY)  
FEDERAL RESERVE BANK OF KANSAS CITY

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X-4813-j

March 4, 1927

Federal Reserve Board,  
Washington, D. C.

Gentlemen:

Attention - Governor Crissinger.

Replying to your letter of February 16th, which is part of a file started on December 31, 1926, by Mr. \_\_\_\_\_, then President of the \_\_\_\_\_ National Bank of \_\_\_\_\_.

In order to answer intelligently the questions you ask in your letter of February 16th, I deferred answer until after a meeting of the Managing Directors of our branches, which was held here yesterday. In the meantime I advised them to come prepared as to facts of the amount of paper now under rediscount with us that bears earmarks as having come from a non-member bank. Since conferring with them, I can say to you that I do not believe there is any paper in this bank that can possibly be construed as coming from a non-member bank.

For further discussion I will take the case of Mr. \_\_\_\_\_ at \_\_\_\_\_, and this is on all fours with nearly every so-called live stock bank at live stock centers, meaning by that, banks that are located at public stock yards. Naturally their business is with the larger live stock operators, scattered over the ranges and feeding sections of our District.

In the case of Mr. \_\_\_\_\_, instead of sending a man from his own bank out into Western Nebraska, to inspect loans for which applications had been made to him by live stock handlers, he selected a man in that section of the country to represent him. He selected a man who was president of a state non-member bank, with the distinct understanding that these loans were no part of the bank's business. The man inspects the cattle, values them, makes the loan, looks after the cattle during the grazing or feeding season, and keeps Mr. \_\_\_\_\_'s bank informed of the progress that is being made with the cattle during the life of this loan. For this service Mr. \_\_\_\_\_ allows the man he has selected one percent or oftentimes two percent on the amount of interest that is charged.

These loans are always too large ever to be taken into any small country banks. The money is furnished by Mr. \_\_\_\_\_'s bank, the notes are drawn to his representative and endorsed by the representative with recourse, bearing, of course, in this way the guarantee of the man who represents him. Predicated upon what I have stated to be the facts, I cannot but feel that this is eligible paper. I know a great number of

bankers who have been doing this throughout their whole banking careers; indeed, I have done it myself when I was in the commercial banking business. I think it is the proper way for a man who specializes in live stock loans to make his loans this way, then have his inspectors go out occasionally and check up on his representatives who are on the ground, and satisfy himself that his interests are being properly taken care of.

Now, in the case of Mr. \_\_\_\_\_, if he had selected a man in that neighborhood who was not connected with a bank, had had the paper drawn on Mr. \_\_\_\_\_'s forms and taken the loan into his bank, I cannot help but feel that it would be eligible for rediscount. I know from my knowledge of the situation that these loans are not made primarily for the purpose of rediscounting with the Federal Reserve Bank, and they are seldom offered to us until a considerable period of the note has run, and then only when some emergency comes into the bank's business and it needs to rediscount.

What I am trying to get at is that because a note bears the endorsement of a man who is the president of a non-member bank, this circumstance need not necessarily make that note ineligible. Whenever we find that a member bank is doing that, we refuse to take the paper. We had an outstanding case of this kind in a bank at \_\_\_\_\_, where the man was covering up the makers of the notes, making the notes on the \_\_\_\_\_ bank's forms, but when we discovered that the makers of these notes, or the endorsers of them were the officers of a non-member bank, and that the proceeds had been passed to the credit of a non-member bank, we at once refused to take the notes, and in this special case the practice has been broken up.

Each one of our Managing Directors told me during the conference yesterday that they are following at the branches exactly the same rule that we have laid down here at the home office and that non-member bank paper is kept out of our rediscounts.

The point I want you to rule upon is that because a note bears the endorsement of a man who is the president or an officer of a non-member bank need not necessarily make that note ineligible for rediscount, when upon investigation we find that the note was made in good faith to the holding member bank and has no relation to, or claim upon, the non-member bank.

I hope I have made myself clear in this matter, and while it is no longer especially vital to us because, as I said, I believe we now have no such paper in the bank of this District; yet, your examiners apparently still raise the question of whether we are not taking non-member bank paper where they find a note bearing the endorsement of a president or officer of a non-member bank.

I reiterate that whenever we find upon investigation that the notes are made on practically the same line as those of Mr. \_\_\_\_\_'s, and there are several - possibly one or two at every live stock center that make their paper this way - I hope you will realize that you are going to

deny, first to the live stock interests and also to the member banks located at stock yards, a great deal of the service of the Federal Reserve System by making a ruling that such paper is ineligible. Of course, Mr. \_\_\_\_\_ could have chosen another man out there, but often this local banker is the best man, and it is for that reason he is chosen, but if he is acting in good faith and Mr. \_\_\_\_\_ is acting in good faith, which we ascertained, I feel the paper should be classed as eligible.

I have the honor to remain,

Very truly yours,

(Signed) W. J. Bailey  
Governor.

(COPY)  
FEDERAL RESERVE BANK OF DALLAS

X-4813-k

February 23, 1927

Federal Reserve Board,  
Washington, D. C.

Gentlemen: Attention Governor D. R. Crissinger.

This will acknowledge receipt of Board's letter X-4794, dated February 17, 1927, relative to eligibility and desirability of notes offered for rediscount by member banks and which are payable to and bear the endorsement of officers of non-member banks, though such non-member banks do not themselves endorse them.

Replying to the Board's inquiry I am glad to say that we cannot recall a single instance where paper of this character has been offered to this bank for rediscount and we hope that none will be offered in the future. Inasmuch as our attention has never been called to loans of this sort in this district it is our opinion that it is not a common practice here, but to the contrary if there are any they are few in number.

Where the proceeds of the loan are used for a purpose that would render it eligible, while it is possible that the endorsement of officers of non-member banks might be merely incidental, under the circumstances stated in the Board's letter where the endorsing officers of non-member banks have a pecuniary interest through a division of earnings received from such loans, prima facie the matter of eligibility is questionable, to say the least. In addition to this, it is apparent that this practice should readily result in the extension of unsound credit which would be still further aggravated if the paper could be passed on to Federal Reserve Banks for rediscount.

It is also conceivable that through separate agreements loans that were in fact made at the instance of non-member banks might in this manner be camouflaged with a view of making them technically eligible for rediscount at Federal Reserve Banks which would not be the case if they bore the actual endorsement of such non-member banks.

In substance, it is our opinion that loans of this character should not be encouraged by a ruling that would make them eligible for rediscount by a Federal Reserve Bank.

Yours very truly

(Signed) Lynn P. Talley  
Governor.

C O P Y

FEDERAL RESERVE BANK OF DALLAS.

144  
X-4813-k-1

March 18, 1927.

Federal Reserve Board,  
Washington, D. C.

Gentlemen:                   Attention Vice Governor Edmund Platt.

I have your letter of March 14, in reply to mine of February 23, and it is apparent that we are discussing two separate propositions, one being a legitimate loan for an eligible purpose and the other a subterfuge to evade legal loan limitations and to use the rediscount facility in a manner not contemplated by law.

I fully agree with you that in a number of instances the resources of banks are not sufficient to finance their larger customers. It is also a fact, as you state, that frequently banks in the larger towns and cities make loans direct to customers of smaller banks and this is particularly true where the smaller banks have already loaned such customers up to their legal limit. Under such circumstances where it is a legitimate transaction and the proceeds are used for an eligible purpose, the notes being offered for rediscount by a member bank, apparently there can be no sound reason for discriminating against them merely because they bear the endorsement of an officer of a non-member bank. In other words, the matter of eligibility and acceptability should always be governed by the facts in the particular case.

On the other hand, it is conceivable that a non-member bank might enter into an arrangement with its correspondent member bank to make loans for its account with a separate agreement to provide for them at maturity, thus violating the spirit, if not the letter, of the law with reference to its legal loan limit and, furthermore, enjoying indirectly the use of the rediscount facility of the Federal Reserve Bank. If the loans are in fact made at the instance of the member bank, instead of the non-member bank, apparently there is no good reason for making them payable to an individual who is an officer of the non-member bank and, in our



C O P Y

- 2 -

X-4813-k-1

judgment, the fact that they are made payable to him, instead of to the member bank which is supposed to have made the loan, should place the Federal Reserve Bank upon inquiry as to the legitimacy of the transaction.

It is our further thought that it is not a sound practice for a member bank to solicit loans and, as I stated in my previous letter, where the officer of a non-member bank has a pecuniary interest through a division of discount or otherwise there would be an incentive through the use of the rediscount facility to manufacture unsound credit.

I hope that this will give you a clearer understanding of the idea that I intended to express in my previous letter and it is still my opinion that nothing would be gained through a ruling of the Board on this subject as the matter of eligibility and credit acceptability would have to be determined by the actual facts in each case.

Yours very truly,

(Signed) LYNN P. TALLEY.

Governor.

F E D E R A L   R E S E R V E   B A N K  
O F   S A N   F R A N C I S C O

February 25, 1927.

Federal Reserve Board,  
Washington, D. C.

Dear Sirs:

In reply to your letter of February 17th (X-4794), you are informed that it is not a general practice in this district for the officers of banks to make commercial loans for correspondent banks and to receive commission for their services. We cannot recall any instance in which a note was offered to us for discount, drawn payable to officers of a non-member bank. Had such paper been submitted, however, and had we detected the fact that the endorsers were officers of non-member banks, we would have inquired into the purpose of making the loan in such form, to determine, first, whether the member bank was applying for funds of the Federal Reserve Bank with the object of extending its business beyond ordinary channels, and, secondly, whether the member bank applying for the discount was acting as agent of a non-member bank.

As you may realize, it is quite a custom for city banks to grant relief to country correspondents by purchasing customers' notes without recourse, or by making direct loans, particularly in the case of excess lines, to customers of country correspondents. The form which these loans take varies quite considerably. Some city banks require, wherever possible, that the loan shall be made on its own form of promissory note. In other instances, they require that the loans shall be made on the form of the correspondent bank, drawn to the order of the borrower or to the order of the country bank, or, in rare instances, to the order of officers of such country bank. Whether or not such notes would be endorsed without recourse would depend upon arrangements agreed upon.

Yours very truly,

(s) Jno. U. Calkins,

Governor.