January 4, 1928.

Mr.Robert S. Parker,
Healey Building,
Atlanta, Georgia.

My dear Bob :

Please accept my most sincere apology for not replying more promptly to your letters of November 23, 26, 29 and December 13 with regard to the complaint of the Smith Dry Goods Company about the presentation of a draft drawn on the form used by the Smith Dry Goods Company in lieu of ordinary bank checks. Pressure of other business, including the final promulgation of the Board's Regulations, have prevented me from replying more promptly to these and a number of other letters which have been on my desk for some time.

I thank you very much for sending me a copy of the letter which you sent to the Smith Dry Goods Company and also for keeping me advised as to the developments - or, rather lack of developments, since it appears from your letter of December 13th that the Smith Dry Goods Company had never replied to your letter. I believe that they were simply endeavoring to get us to admit that we could not handle such items as cash items, and I rather expect to see an attempt made to broaden the use of such items. If such a tendency should develop, it may become necessary for us to find some way to stop it.

In your letter of November 23rd you say that it has been your thought that a draft drawn by an individual on himself to the order of a named person, even though "through a bank" is essentially so different from a check drawn against deposits in a member bank that the prohibition in the "caudel appendage" of the Hardwick Amendment could hardly be taken as applicable thereto. I never have seriously considered any effort to classify these items as "checks", but I believe that they could be classified as "drafts" and I think it is very important for us to bear in mind the fact that the Hardwick Amendment applies to drafts as well as to checks. The only difficulty about the matter is that the term "drafts" has been held by the courts to be synonymous with "bills of exchange", and if we construe it as applying to drafts of this kind there is no telling where such a construction will lead us. We might even be asked to handle bill of lading drafts at par, which would be quite unfortunate.

In your letter of November 29th, you discuss the question whether these items could be brought within the terms of the Hardwick Amendment as being included in the term "checks and drafts" but raise some objections based upon the lack of uniformity in the so-called "Uniform Negotiable Instruments Law and the fact that Section 87 thereof has not been enacted in all the States. In my opinion, however, these items could clearly be called "drafts", irrespective of the existence or non-existence of Section 87 of the Negotiable Instruments Act, since the courts have held that the term "draft" is synonymous with "bill of exchange"

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

and these items clearly are bills of exchange. I do not think it makes much difference whether they are payable at a bank or through a bank or whether the customer has instructed his bank to pay them. The difficult question is: How can we rule that these drafts come within the terms of the Hardwick Amendment and other bills of exchange do not? The only solution that occurs to me is to take the position that the term "drafts" as used in the Hardwick Amendment was intended to apply to drafts which are intended to serve the purpose of a check and not to ordinary bills of exchange. In other words, a draft drawn upon a customer's own bank might be construed as a remittance of funds as distinguished from a draft drawn upon any other debtor, which is in the nature of a piece of commercial paper or a means of effecting the collection of a debt. It seems to me that the former might properly be classed as cash items since they constitute a means of effecting payment or making a remittance; whereas, the other items might be treated as collection items since their purpose is either to effect a collection or to be used as a means of borrowing money through the discount of such items. The distinction I have in mind is a practical rather than a legal distinction and it is difficult for me to express it clearly. It would be even more difficult to draft a regulation clearly distinguishing between these two classes of items. For these reasons, I hope that it will never be necessary for us to classify such items as drafts in order to prevent the banks from circumventing the Hardwick Amendment.

For the present, I think the question is academic; since I do not believe that the practice is very likely to spread to such an extent in the near future as to make it necessary for us to take some restrictive action.

Your letter of November 26th raises a practical question as to what the Federal reserve banks should do when items of this kind come to them in cash letters - i.e., whether they should detach them from the cash letters and handle them as collection items, whether they should request further instructions, or whether they should be returned. This is essentially a practical question which I am not prepared to solve; but, off-hand, I would be inclined to think that such items should be returned unless the Federal reserve bank has specific instructions to handle them as collection items; because I believe that in this way we could best discourage the practice of using these items in lieu of checks. The question is a rather important one, however, and probably one on which a system policy should be adopted.

Please let me know whether your bank has adopted a definite policy as to the method of handling these items or whether you think this question should be discussed with a view of evolving a system policy with reference thereto.

With kindest personal regards, I am,

Cordially yours,

Walter Wyatt,
General Counsel.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

X-5050-a

FEDERAL RESERVE BANK
OF ATLANTA

December 13, 1927.

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

Dear Walter:

You will recall that some time since the Federal Reserve Bank sent a letter to the Smith Dry Goods Company of Greenville, Alabama, which letter had reference to the return without presentation of a draft drawn in the form used by the Smith Dry Goods Company in lieu of ordinary bank checks. The Reserve Bank has never received a reply to that letter. I am merely passing this information on to you so that your files may be complete.

It seems to be the custom in Alabama not to reply to letters that are sent out on the subject of irregular, anomalous or restricted checks. You will recall that none of the banks, which formerly restricted their cashiers checks against payment through the Federal Reserve Bank, acknowledged receipt of the letter addressed by the Reserve Bank to them on the subject.

Very truly yours,

(SIGNED) Robt. S. Parker

Robt. S. Parker.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

FEDERAL RESERVE BANK
OF ATLANTA

X-5050-b

November 29, 1927.

Mr. Walter Wyatt,
c/o Federal Reserve Board,
Washington, D. C.

Dear Walter:

This letter is written with further reference to yours of November 21st, in which you discuss the question of whether or not the Federal Reserve Board might, by regulation, require the payment at par by member banks of drafts drawn on third persons but payable "through" such banks.

You have given considerable study to the question, as is evident from the very excellent memorandum enclosed with your letter. I have given very little study to the matter, as will probably be made equally evident by this matter. I am, however, venturing to advance certain ideas which may have a bearing on the matter.

I am inclined to the opinion that it would not be practicable - if indeed legal - to undertake to bring drafts, drawn in the form used by the Smith Dry Goods Company, within the category of cash items, to be handled as such. I recognize the fact that the Federal Reserve Act prohibits member banks from exacting exchange charges both on "checks and drafts" forwarded to them for payment by the Reserve Banks, and that, under the Negotiable Instruments Law as it has been enacted in most of the States, an instrument made payable <u>at</u> a bank is equivalent to an order to the bank to pay the same for the account of the principal debtor thereon.

Assuming for the moment that a draft payable <u>through</u> a bank is the same in legal effect as one payable <u>at</u> a bank, there are certain practical difficulties in the way, to which I refer.

In Georgia, and in at least one other State, Section 87 of the Negotiable Instruments Act reads, in effect, that an instrument made payable at a bank "shall not be" equivalent to an order to the bank, etc. The statutes of Illinois, Nebraska, South Dakota and North Dakota contain no such provisions as are ordinarily embodied in Section 87. The statutes of Missouri, New Jersey and Arkansas differ from the "uniform" Act, although the differences in the Acts of the last mentioned States are doubtless not material. In the States where Section 87 is not of force, and in the States where Section 87 as enacted is directly contrary to the tenor of the uniform Act I do not believe that a draft drawn on a third person, whether or not expressly made payable at a bank, could be regarded as being the legal equivalent of a check.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Furthermore, certain of the States still allow days of grace for the payment of sight drafts. In Massachusetts all drafts and bills of exchange made payable within the State at sight are allowed three days of grace unless there is an express stipulation to the contrary. In New Hampshire there is the same provision. In Rhode Island there is a provision of the same tenor, although the language used is different from the language in the Massachusetts and New Hampshire Acts. There is a provision for days of grace upon sight drafts payable in North Carolina under certain conditions pointed out in the Act.

I am not certain, furthermore, whether an instrument payable through a bank would have the same legal effect as an instrument payable at a bank. I have not looked into this phase of the question at all, but it strikes me offhand that the phrase "payable through" a bank might be taken as merely indicating a channel through which presentation is desired, whereas an instrument payable at a bank is, of course, payable where designated. In my own practice I have frequently drawn drafts on individuals or firms "in care" of a designated bank, and I believe that a notation that a draft is payable through a bank might be taken as meaning little more than the furnishing of an address at which the drawee could be reached.

It seems to me, also, that the Hardwick Amendment was framed with reference to checks and drafts drawn on a bank itself rather than to bills of exchange drawn on individuals, whether or not made payable at a bank.

On the practical side there would seem to be difficulties also. Bankers are reluctant to treat drafts drawn on persons other than bankers as they treat cash items. For example, many bankers allow good customers, who maintain satisfactory balances, to draw against balances created by deposits of checks payable at a distance before the same are collected, whereas very few bankers allow their customers to draw against uncollected drafts that are not drawn upon banks or bankers.

I do not wish you to think that I am undertaking to give any matured opinion, or to express to you the views of the Federal Reserve Bank of Atlanta. What is said in this letter is purely a personal opinion and the same is written to you informally because I am very much interested in the question even though I have not given it the study which you have.

With best personal regards, I am,

Cordially yours,

(signed) Rbt. S.Parker

Robert S. Parker.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

FEDERAL RESERVE BANK
OF ATLANTA

November 26, 1927.

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

Dear Walter:

Reference is made to our prior correspondence concerning the Smith Dry Goods Company drafts. As I previously advised you, the custom of the Birmingham Branch of the Atlanta Bank seems to have been to treat such paper as non-cash items, returning the same in the absence of specific instructions to handle as collection items.

Although the matter has not been put up to me for decision, I have been wondering whether it would be better for the Bank to handle such items as at present or, in cases where they are sent enclosed with cash letters, merely to detach the same and send them forward as collection items. Another course of procedure might be to notify endorsers by wire, in such cases, that the drafts could not be handled as cash items but would be handled for collection upon the receipt of telegraphic instructions.

I am clearly of the opinion that, under the present Regulations of the Board, the Bank can not handle such paper as cashitems. I am further of the opinion that the Bank would be strictly within its rights, in cases where such items come to it enclosed with cash letters, in returning the items to endorsers. I am also of the opinion (although there may be some doubt about the matter) that, even though the drafts reach us in cash letters, the Bank could handle the same for collection even without waiting for specific instructions to do so. Were, however, this latter method of handling to be adopted, it would mean "playing" into the hands of the local banks, since the drafts would, in such cases, receive prompt handling and exchange charges would be exacted for remittance.

On the other hand, the Federal Reserve Bank wishes to give prompt and satisfactory service, and the return of paper which could be handled as collection items might, in some cases, entail loss to the holders of the drafts, and in any event collections would be delayed thereby.

After thinking the matter over, I have about reached the conclusion that perhaps the best method of handling would be to remove

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

such items from cash letters, advising endorsers that the same can not be handled as cash items and requesting instructions by wire. I have not wished, however, to form any definite opinion without corresponding informally with you about the matter. I shall appreciate your consideration of this matter and any suggestions which you may care to give.

With best personal regards, I am,

Very truly yours,

(signed) Rbt. S. Parker

Robt. S. Parker

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

FEDERAL RESERVE BANK
OF ATLANTA

November 23, 1927.

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

Dear Walter:

Herewith enclosed you will find two copies of the form of letter which I have prepared to be sent by the Federal Reserve Bank to the Smith Dry Goods Company of Greenville in reply to its letter of November 14th.

The form of letter prepared is in the form of my original draft as revised in accordance with the very helpful suggestions which you made.

I read with great interest your letter to me of November 21st, as well as the memorandum enclosed therewith.

Off hand, I am very much inclined to agree with your conclusion that the Federal Reserve Board would have the right under the Act to require the payment at par of sight drafts if the same could be construed as orders drawn on member or clearing member banks.

Despite, however, the sections of the Negotiable Instruments Act to which Mr. Baker refers and your very excellent memorandum, it has been my thought that a draft drawn by an individual on himself to the order of a named person, even though payable "through a bank" is essentially so different from a check drawn against deposits in a member bank that the prohibition in the "caudal appendage" of the Hardwick Amendment could hardly be taken as applicable thereto. Of course, if the drawer of the draft had given the bank standing instructions to pay all paper upon presentation, the legal relationship between the bank and its customer might, in such event, be closely analogized to the ordinary relationship which exists with respect to the payment of depositor's checks.

The whole matter is somewhat novel to me and I have not given it sufficient thought to make my observations of any value.

I am also rather hurried this morning since I am leaving for Birmingham this afternoon, where I hope to see the University of Georgia at last defeat Alabama.

I want to write you more about the matter within the next few days.

With best personal regards, I am,

Cordially yours,
(signed) Rbt. S. Parker
Robt. S. Parker.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

FEDERAL RESERVE BANK
OF ATLANTA

November 23, 1927.

Smith Dry Goods Company,
Greenville, Alabama.

Gentlemen:

We received on November 18th a letter from you bearing date of November 14th, in which you stated that on October 31st you mailed a check to S. Goldberg & Company, 1359 Broadway, New York, for $27.37, using a form of check which you enclosed with your letter. You further stated that said check had been returned to you after the same had been returned by the Federal Reserve Bank to the bank of original deposit and by the latter bank to the payee, S. Goldberg and Company. You asked in your letter why this paper was not sent on to your bank, where the same would have been paid and charged to your account, instead of being returned without presentation to the First National Bank of Greenville.

We find, on inquiry of the Birmingham Branch of this bank, that the item in question was received by said Branch in a cash letter, dated November 5th, and sent to it direct by the First National Bank of Jersey City for the account of the Federal Reserve Bank of New York; that the same was returned for the reason that it was not a check drawn on a bank, and the Branch had no instructions to handle it as a collection item. In fact, our standing instructions from the Federal Reserve Bank of New York were to return all items which could not be collected at par.

In order that the above may be clear to you, we add the following explanation:

This bank, and all other Federal Reserve Banks, handle checks pursuant to a Regulation of the Federal Reserve Board known as Regulation J, which Regulation defines checks as follows:

> "A check is generally defined as a draft or order upon a bank or banking house, purporting to be drawn upon a deposit of funds, for the payment at all events of a certain sum of money to the order of a certain person therein named, or to him or his order, or to bearer, and payable on demand."

All other items are handled as "non-cash collection items" when requested by the sending bank.

The form of instrument submitted with your letter is not a check. The same is a draft, drawn by your Company on itself and payable to the order of a named person. You will, of course, note the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

distinction. If the instrument were a check it would be drawn by you on the bank, not by you on yourselves and payable through a bank.

Under banking usage the term "cash items" ordinarily means checks drawn upon banks or bankers against purported deposits and payable on demand. As above stated, the item to which you refer was sent to our Birmingham Branch as a cash item, to be handled as such. We had no instructions to handle the same as a draft or collection item. This difference is important. The Federal Reserve Act prohibits the making of exchange charges against the Federal Reserve Banks and, therefore, makes it illegal for the Federal Reserve Banks to pay such charges. Your bank at Greenville is a member bank and remits at par to the Federal Reserve Bank for all checks drawn upon it and presented by the Reserve Bank for payment and remission of proceeds. Had the item to which you refer been drawn upon the bank it would have been sent forward in the usual way and would have been paid at par upon presentation through the mails. The item, however, was drawn upon you and, although payable by you "through the First National Bank of Greenville", was not a check as defined in the Regulations of the Federal Reserve Board, and could not be handled as a cash item under the Board's existing Regulations. We repeat that our instructions from the Federal Reserve Bank of New York were to return any item which could not be collected at par.

We have gone into the above in considerable detail since, in your letter, you complain of having been embarrassed by the return of the "check". Whether you desire to pay your obligations by ordinary bank checks or by drafts drawn in the form submitted with your letter is, of course, your own business, and we do not wish you to think that we are trying to make suggestions as to the conduct of your affairs. Inasmuch, however, as you have asked us to give you an explanation of our handling of the draft, we deem it not amiss to add that if you use checks drawn in the usual form on your bank they will be handled as cash items, whereas drafts drawn on yourself cannot, under the Regulations of the Board, be so handled.

In your letter you state, in effect, that this Bank only "occasionally selects" one of your checks to return "while hundreds of them come through in the regular way" and are paid by your bank. The Birmingham Branch advises that it is its custom to handle any paper, drawn in the form submitted with your letter, in the manner indicated above. While we have no definite information on the subject, it is probable that some of your paper has reached the Branch with instructions to handle for collection, and that the same has been handled in accordance with such instructions, as would have been done in the instant case had the item reached us with instructions to handle as a collection item instead of as a cash item.

We are glad that you wrote us about the matter and shall be pleased to supplement this letter if it is not entirely clear to you.

Very truly yours,
M. B. Wellborn,
Governor.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

November 21, 1927.

Honorable Newton D. Baker,
Union Trust Building,
Cleveland, Ohio.

My dear Mr. Baker:

I have received your wire of November 21st with reference to Mr. Parker's letter addressed to me under date of November 19th, and I regret to say that I disagree with the suggestion contained therein.

The election of the holder to treat these instruments as bills of exchange pursuant to the terms of section 130 of the Negotiable Instruments Act would have no effect except to classify them as bills of exchange rather than notes; and the making of them payable at a bank would not, in my opinion, make them technically "checks", even though, under the terms of section 87 of the Negotiable Instruments Act, they would be "equivalent" to orders on the bank to pay the same for the account of the principal debtor thereon.

On the other hand, I am inclined to the view that these items in their present form may properly be considered "drafts" within the meaning of the Hardwick Amendment, for reasons which are explained in detail in memorandum which I addressed to the Board under date of November 11th, a copy of which is enclosed herewith for your information.

As stated in that memorandum, I think it would be best for the Federal reserve bank to continue at present to handle these items as non-cash items; but I think that we should be very careful not to take the position that they cannot be handled as cash items under the terms of the Hardwick Amendment. This is especially important, because it appears that the E. H. Smith who addressed the letter to the Federal Reserve Bank on behalf of the Smith Dry Goods Company is a director of the First National Bank of Greenville, Alabama, and that a certain Park Smith is Vice President of that bank, all of which leads me to believe that this letter is an attempt to trap the Federal reserve bank into an admission that these items cannot be handled as cash items under the terms of the law.

I think it would be much better for the Federal reserve bank to take the position that they are not technically "checks" within the meaning of the Board's existing Regulation J and say nothing about the question whether they may be considered drafts within the meaning of the Hardwick Amendment. This would leave us free to amend Regulation J so as to include these items if this practice should spread to such an extent as to make it necessary to do so. I, therefore, suggested to Mr. Parker certain changes in the phraseology of his letter in accordance with these views, and I enclose for your information a copy of a telegram and letter which I have sent to Mr. Parker.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The Board has not yet taken any action on my memorandum of November 11th and, therefore, everything said in that memorandum as well as everything contained in this letter should be considered merely an expression of my own personal views and not as representing in any way the views of the Federal Reserve Board.

Hastily, but with kind personal regards, I am,

Sincerely yours,

(signed)

Walter Wyatt,
General Counsel.

Enclosures.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

TELEGRAM X-5050-g

FEDERAL RESERVE SYSTEM

Cleveland Nov 21 Received at Washington, D.C.
Nov 21 1927

Water Wyatt
Washn

Have read Parker's letter to you of November 19 and accompanying papers, Do you not think it would be wise to call Parker's attention to sections 87 and 130 of the negotiable instruments act and suggest his adding to his letter a paragraph as follows:
"We call your attention to sections 87 and 130 of the negotiable instruments act. If you will change the word 'through' to 'at' before first national bank and instruct the payee to endorse thereon his election that the instrument shall be treated as a bill of exchange, the Federal Reserve Bank will, of course, treat the matter as a check and handle it for payment without exchange charges in accordance with the Federal Law on that subject.

Baker

1144am

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

X-5050-h

November 21, 1927.

Mr. Robert S. Parker,
Healey Building,
Atlanta, Georgia.

My dear Bob:

This is in further reply to your letter of November 19th enclosing a copy of a letter addressed to the Federal Reserve Bank of Atlanta by the Smith Dry Goods Company of Greenville, Alabama, and a copy of the proposed reply which you had prepared.

Your proposed reply is a very excellent letter; and I would have no suggestions to offer if I were prepared to admit that these items could not properly be handled as cash items under the terms of the Federal Reserve Act and that the Federal Reserve Board could not properly require them to be paid at par. The Hardwick Amendment, however, applies to "checks and drafts"; and I am of the opinion that items such as these can be construed to be "drafts" within themeaning of the prohibition against exchange charges, especially where they are intended to circulate as checks. For the present, I believe it will be best to continue to handle such items as non-cash items, on the theory that Regulation J applies only to checks as defined therein; but, if this practice should spread to such an extent as to endanger seriously the success of the par clearance system, it might become necessary sometime in the future to amend Regulation J so as to include these items. In view of this possibility, I think it would be extremely unfortunate to take the position that these items "could not be regarded as the legal equivalent of a check drawn on the bank"; and I believe that it would be better to change your letter so as to base your refusal to handle these items as cash items on the terms of the Board's present Regulation J rather than on the terms of the law. This is especially important in view of the fact that it appears from the Bankers' Directory that the E. H. Smith, who dictated the letter addressed to the Federal Reserve Bank of Atlanta by the Smith Drygoods Company, is a director of the First National Bank of Greenville, Alabama, and that a certain Park Smith is Vice President of the same bank, all of which leads me to believe that the letter is an effort to trap the Federal Reserve Bank into an admission that these items cannot be handled as cash items under the terms of the Federal Reserve Act.

I enclose a copy of a telegram which I received from Mr. Baker containing suggestions regarding your letter; but I do not agree entirely with Mr. Baker's views. I do not think that the changes which he

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

suggests would make these items "checks" within the meaning of Regulation J, nor do I think it safe to take the position that in their present form they are not "drafts" within the meaning of the Hardwick Amendment.

I also enclose for your information a copy of a memorandum which I have addressed to the Board on this subject which contains a more complete expression of my views as to the proper method of handling this situation and as to the legal phases thereof. The Board has not yet acted on this memorandum; and every statement contained therein as well as every statement contained in this letter should be considered merely an expression of my own personal views and not as indicating the views of the Board in any way.

Hastily, but with all best regards, I am,

Cordially yours,

Walter Wyatt,
General Counsel.

Enclosures.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

X-5050-i

LEASED WIRE SERVICE

November 21, 1927.

Parker - Atlanta

Your letter November 19. Consider your letter an excellent one, but would suggest following modifications. Insert after third paragraph a new paragraph as follows: "This bank handles checks pursuant to a regulation of the Federal Reserve Board known as Regulation J, which defines checks as follows: (quote definition). All other items are handled as 'non-cash collection items' when requested by the sending bank". Omit second sentence, fourth paragraph. Change next to last sentence, fifth paragraph, to read: "The item, however, was drawn upon you and, although payable by you at the bank, was not a check as defined in the regulations of the Federal Reserve Board and could not be handled as a cash item under the Board's existing regulations". Make any other changes necessary to harmonize letter with these suggestions. If it is true that you have handled hundreds of these items during the past three years think that you should explain such action. Letter follows.

WYATT

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

FEDERAL RESERVE BANK
OF ATLANTA

November 19, 1927.

Mr. Walter Wyatt, General Counsel,
Federal ReserveBoard,
Washington, D. C.

Dear Walter:

On yesterday the Federal Reserve Bank of Atlanta received a letter from Smith Dry Goods Company of Greenville, Alabama, written under date of November 14th, a copy of which I hand you herewith, also a copy of the form of draft which was enclosed with the Smith Dry Goods Company's letter. When the matter was called to my attention I decided that it would be best to have any reply to the letter approved by you and Mr. Baker since it is possible that the letter may have a significance not now apparent. At any rate, it would seem to furnish a good opportunity to "educate" at least one person who is lending himself to the plan of the Greenville, Alabama, bank to evade the par collection provisions of the Federal Reserve Act.

I have prepared, and enclose herewith, a tentative reply to the above letter. I would be glad if you would criticize the same and, if possible, let me have your suggestions or criticisms by wire on Monday. A copy of this letter is being sent to Mr. Baker with the same request for suggestions or criticisms.

I have, as you know, been of the opinion that a draft drawn by an individual on himself to the order of a third person is not a "check or draft" with respect to which the Reserve Bank can require a par remittance. I believe that the bank would have the right to handle the same as a collection item. Whether or not such items, when received, should be detached from the cash letter and sent forward as collection items, or whether they should be returned, is a matter which should have consideration in the near future.

If Mr. Baker should happen to be away from his office on Monday please wire me your views and instructions, since I would like to answer the Smith Company's letter as soon as possible. So far, the Federal Reserve Bank has merely acknowledged receipt of the letter, stating that it would communicate with the Birmingham Branch of the Bank as to the details of the handling, and then advise further.

With best personal regards, I am,

(signed) Rbt. S. Parker
Robt. S. Parker,
of General Counsel.

Copy to:
Mr. Newton D. Baker,
Union Trust Building,
Cleveland, Ohio.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Smith Dry Goods Company,
Greenville, Alabama.

Gentlemen:

We received on November 18th a letter from you bearing date of November 14th, in which you stated that on October 31st you mailed a check to S. Goldberg & Company, 1359 Broadway, New York, for $27.37, using a form of check which you enclosed with your letter. You further stated that said check had been returned to you, after the same had been returned by the Federal Reserve Bank to the bank of original deposit and by the latter bank to the payee, S. Goldberg & Company. You asked in your letter why this paper was not sent on to your bank, where the same would have been paid and charged to your account, instead of being returned without presentation to the First National Bank of Greenville.

We find, on inquiry ofthe Birmingham Branch of this bank, that the item in question was received by said Branch in a cash letter, dated November 5th, and sent to it direct by the First National Bank of Jersey City for the account of the Federal Reserve Bank of New York; that the same was returned for the reason that it was not a check drawn on a bank, and the Branch had no instructions to handle it as a collection item.

In order that the above may be clear to you, we add the following explanation.

The form of instrument submitted with your letter is not a check. A check, as that term is understood in ordinary business parlance as well as in law, is an order upon a bank, purporting to be drawn upon a deposit of funds for the payment, at all events, of a certain sum of money, to the order of a certain person therein named, or to him or his order, or to bearer, and payable on demand. The instrument which you use is a draft, drawn by your Company on itself and payable to the order of a named person. You will, of course, note the distinction. If the instrument were a check, it would be drawn by you on the bank, not by you on yourselves and payable through a bank.

Under banking usage the term "cash items" means checks drawn upon banks or bankers against purported deposits and payable on demand. As above stated, the item to which you refer was sent to our Birmingham Branch as a cash item, to be handled as such: We had no instructions to handle the same as a draft or collection item. This difference is important under the Federal Reserve Act. The Federal Reserve Act prohibits the making of exchange charges against the Federal Reserve Banks and, therefore, makes it illegal for the Reserve Banks to pay such charges. Your bank at Greenville is a member bank and remits at par to the Reserve Bank for all checks drawn upon it and presented for payment and remission of proceeds by the Reserve Bank. Had the itemto which you refer been drawn upon the Bank it would have been sent forward in the usual way, and it would have been paid at par upon presentation through the mails. The item, however, was drawn upon you and, although payable by you at the bank, could not be regarded as the legal equivalent of a check drawn on the bank. Our instructions from the Federal Reserve Bank of New York were to return any item which could not be collected at par.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

We have gone into the above in considerable detail since, in your letter, you complain of having been embarrassed by the return of the "check". Whether you desire to pay your obligations by ordinary bank checks or by drafts drawn in the form submitted with your letter is, of course, your own business, and we do not wish you to think that we are trying to make suggestions as to the conduct of your affairs. Inasmuch, however, as you have asked us to give you an explanation of our handling of the draft, we deem it not amiss to add that if you use checks drawn in the usual form on your bank they will be handled as cash items, whereas, drafts drawn on yourself can not be so handled.

We are glad that you wrote us about the matter and shall be pleased to supplement this letter if it is not entirely clear to you.

Very truly yours,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

X-5050-1

SMITH DRY GOODS COMPANY

No. ______________

GREENVILLE, ALA. ______________192_

Pay to the
Order of ____$______________

____DOLLARS

TO SMITH DRY GOODS CO.

Through First National Bank 61-121

Greenville, Alabama.

____

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

X-5050-m

SMITH DRY GOODS COMPANY

"The Ladies Store"

EVERYTHING FOR LADIES AND CHILDREN

Greenville, Ala.

Nov. 14, 1927.

The Federal Reserve Bank,
Atlanta, Ga.

Gentlemen:

On Oct. 31 we mailed check to S. Goldberg & Co., 1359 Broadway, New York, N. Y. for $27.37 covering amount due them, using the form of check enclosed herewith, which form we have been using for several years, and same was returned to us after having been returned by The Federal Reserve Bank to their bank and by their bank to them.

Now this check, as are all checks drawn by us, was protected on the day drawn by ample funds in our bank to cover same, was endorsed by S. Goldberg & Co., and deposited in their bank, The First National Bank of Jersey City, and was endorsed by that bank, and we can not understand why this check was not sent on to our bank where same would have been promptly paid and charged to our account instead of being returned without even being presented at our bank.

It seems to us that the endorsements on this check would have been ample protection to you and we feel that you have no right to embarrass us by returning our checks instead of allowing them to come through for payment, nor do we understand why you should just occasionally select one to return while hundreds of them come through in a regular way and our bank has never refused payment on one of them.

Thanking you in advance for prompt reply in explanation of your action in this matter, we are,

Yours very truly,

Sgn.

SMITH DRY GOODS CO.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

November 11, 1927

Federal Reserve Board

Mr. Wyatt - General Counsel.

New Effort of Certain Alabama Member Banks to Avoid Par Clearance.

The attached letter addressed to the Board by Governor Wellborn calls attention to a new practice adopted by a few small member banks in Alabama for the purpose of avoiding the payment of their checks at par. It appears that in lieu of ordinary bank checks these banks have encouraged their customers to draw drafts on themselves payable through their local banks.

At present, the Federal Reserve Bank of Atlanta is handling these items as non-cash collection items, but invites the Board's suggestions or instructions.

OPINION

While the question is not at all free from doubt, I am of the opinion that these items come within the terms of that provision of Section 13 of the Federal Reserve Act which, in effect, forbids member banks to exact exchange charges on "checks and drafts" forwarded to them for payment by Federal reserve banks.

This practice, however, is confined at present to a few small and relatively unimportant banks, and is not very likely to spread because it is not in accordance with the usual business procedure. I am of the opinion, therefore, that it would not be advisable for the Board to institute any proceedings designed to compel these few small banks to discontinue the practice, unless and until the practice shows a tendency to spread. If the practice spreads sufficiently to threaten the success of the par clearance system, I think the appropriate remedy would be the same as that followed in the case of checks stamped "Not payable through a Federal reserve bank". That practice was successfully checked by having the Federal Reserve Bank advise the member banks which had adopted the practice that it was in violation of the Federal Reserve Act and that if such banks did not remit at par for such checks the Federal Reserve Bank would charge them to their reserve accounts.

DISCUSSION

It appears that the items in question are in the form of bills of exchange drawn by individuals on themselves payable on demand at the banks with which such individuals have accounts. They are not technically checks, because they are not drawn on banks. Section 87 of the Negotiable Instruments Law, however, reads as follows:

> "Where the instrument is made payable at a bank it is equivalent to an order to the bank to pay the same for the account of the principal debtor thereon."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Under this section, the banks are authorized to pay these items and charge them to the accounts of their customers. Thus, in practice, these items serve the same purpose as checks and may be handled by the drawee banks in the same manner as ordinary checks. While they are not technically checks, it would seem that they clearly come within the term "drafts" as used in that provision of Section 13 of the Federal Reserve Act which, in effect, forbids members to exact exchange charges on "checks and drafts" forwarded to them for collection or payment by Federal Reserve Banks.

Section 13 authorizes Federal reserve banks to handle two classes of items: (1) "Checks and drafts payable upon presentation", and (2) "Maturing notes and bills". "Checks and drafts payable upon presentation" may be received on deposit, but "maturing notes and bills" may be received only "for collection". This indicates a clear intent to distinguish between these two classes of items; but the line of demarcation is rather vague, because of the fact that the term "drafts" is a non-technical term with no well defined meaning and has generally been construed by the courts as being synonymous with bills of exchange.

> "A draft is the common term for a bill of exchange. The terms 'draft' and 'bill of exchange' are commonly used synonymously. The term 'drafts' as used in a statute is sometimes held broad enough to cover checks." 8 Corp. Juris 40.

Because of the fact that the term "maturing notes and bills" is broad enough to include bills of exchange, it has generally been assumed that bills of exchange should be received only for collection and handled as non-cash collection items, and that practically the only itemswhich should be handled as cash items are checks and so-called "bank drafts" which are really checks drawn by one bank on another.

It is not entirely clear, however, that this is the proper construction of the law. It could be argued with much force that the term "maturing notes and bills" should be construed to apply only to notes and bills payable on a definite date or a certain number of days after date, and that bills of exchange payable at sight or on demand should be classed as "drafts payable on presentation". Such a construction would be consistent with one of the Board's rulings to the effect that bills of exchange payable at sight or on demand may not be rediscounted by Federal reserve banks because they have no definite maturity, and, therefore, cannot be said to "have a maturity at the time of discount of not more than 90 days, exclusive of days of grace." It would be unfortunate, however, to classify all bills of exchange payable at sight or on demand as "drafts payable on presentation" and require the Federal reserve banks to handle them as cash items, because such a ruling necessarily would apply to bill of lading drafts and numerous other bills of exchange which normally and properly are handled as collection items.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Nor do I think that it is necessary to go this far in order to rule that the items in question are properly included in the term "checks and drafts payable on presentation". It would seem logical to construe that term as applying only to checks and such bills of exchange as are intended to serve the purpose of checks. Such a construction would seem to conform to the purpose of the Act; would be consistent with usual banking practice; and would prevent devices such as this to evade the par clearance of checks, without at the same time requiring Federal reserve banks to handle as cash items all bills of exchange payable at sight or on demand.

If it should ultimately be necessary to have a test case on this question, I believe that, by proper explanation of the history, purpose and effect of the first paragraph of Section 13, it would be fairly easy to get the court to see this distinction and to rule that items such as those now under consideration come within the term "checks and drafts payable on presentation" without at the same time ruling that this term includes all bills of exchange payable at sight or on demand.

The so-called Hardwick Amendment, of course, does not apply to "maturing notes and bills", but does apply to "checks and drafts". It is therefore clearly intended to apply to that class of items which Federal reserve banks are authorized to receive on deposit; and the prohibition against making exchange charges against Federal reserve banks, which has been construed by the courts as a prohibition against member banks exacting such charges on checks forwarded to them by Federal reserve banks for payment, applies only to "checks and drafts" and not to "maturing notes and bills".

Section 16 of the Federal Reserve Act contains the following provision, which was the original requirement for par clearance:

> "Every Federal reserve bank shall receive on deposit at par from member banks or from Federal reserve banks <u>checks and drafts</u> drawn upon any of its depositors, and when remitted by a Federal reserve bank, <u>checks and drafts</u> 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."

Here, again, par clearance is required as to "checks and drafts" and not as to "maturing notes and bills". This provision also would seem broad enough to include bills of exchange intended to circulate as checks and might logically be construed as not applying to bills of exchange not intended to circulate as checks although they are payable at sight or on demand.

I am of the opinion, therefore, that it is a violation of the par clearance provisions of the Federal Reserve Act for a member bank to charge exchange on items of the kind described above when such items are forwarded to them by a Federal reserve bank for payment as cash items.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Under the Board's existing regulations, however, such items are not classed as cash items, because Regulation J applies only to "checks" and contains a foot-note defining a check as follows:

"A check is generally defined as a draft or order upon a bank or banking house, purporting to be drawn upon a deposit of funds, for the payment at all events of a certain sum of money to the order of a certain person therein named, or to him or his order, or to bearer, and payable on demand."

If the Board wishes to take the position that these items must be handled as cash items and that member banks must remit for them at par, it would be necessary to amend Regulation J so as to apply to "checks and drafts" or amend the definition of a "check" so as to include bills of exchange payable at a bank, at sight or on demand, and intended to circulate as checks.

Since Regulation J does not now apply to this class of items, it is entirely correct for the Federal Reserve Bank of Atlanta to refuse to handle them except as non-cash items. If the Board, however, should amend Regulation J so as to apply to all bills of exchange payable at banks on sight or on demand and intended to circulate as checks, all Federal reserve banks will be required to handle such items as cash items. There are a number of practical reasons why it would be inadvisable to require this unless it becomes necessary to do so in order to meet a serious attack on the par clearance system.

While the device adopted by these few Alabama banks is a very ingenious device, and, if resorted to by a large number of banks, would constitute a serious attack on the par clearance system, I do not believe that it is of sufficient importance at the present time to warrant such a change in the Board's regulations or to warrant any affirmative action on the part of the Federal Reserve Board or the Federal reserve bank against these few small member banks to compel them to stop the practice.

If, however, the practice should spread to such an extent as to constitute a serious menace to the success of the par clearance system, then I would recommend that the Board amend Regulation J in the manner suggested above and adopt the same procedure with reference to these banks that it adopted with reference to checks stamped "Not payable through a Federal reserve bank". With reference to those checks, the Board addressed a letter to the Federal Reserve Bank of Atlanta advising such bank that the stamping of this device on checks of a member bank was in conflict with the provisions of the Federal Reserve Act and instructed the Federal Reserve Bank to collect such checks at par even if it were necessary to charge them to the account of the drawee banks. The Federal Reserve Bank advised the drawee banks of the instructions which it had received from the Federal Reserve Board, and I am informed that these banks which had adopted the practice of stamping their checks "Not payable through the Federal reserve bank" either discontinued the practice of stamping their checks in this manner or remitted for them at par, so that attack on the par clearance system was successfully met.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

If the banks which had stamped their checks "Not payable through a Federal reserve bank" had refused to remit at par for such checks, it was the plan of Mr. Baker, Mr. Parker, and myself to have the Federal Reserve Bank charge them to the reserve account of the drawee bank until the matter was brought to an issue in one of two ways:

(1) We hoped that if these banks intended to test the question in the courts they would bring a suit to enjoin the Federal reserve bank from charging such items to their accounts, and thus the legality of the practice could be tested out in an ordinary civil suit brought by the offending banks against the Federal Reserve Bank, which would put us in the best tactical position.

(2) If these banks persisted in refusing to remit for such checks at par but failed to bring any suit against the Federal Reserve Bank, we thought it might be necessary, as a last resort, to test the question in a suit brought by the Comptroller of the Currency to forfeit the charter of one of these banks for failure to maintain the reserves required by Section 19 of the Federal Reserve Act. This would have enabled us to test the question in the courts, but would have been undesirable for tactical reasons, and Mr. Baker, Mr. Parker and myself were all agreed that it was a remedy which we should use only as a last resort.

CONCLUSION

If the practice described in Governor Wellborn's letter should spread to such an extent as to constitute a serious menace to the success of the par clearance system, I think we should follow the same procedure as was outlined for the checks stamped "Not payable through a Federal reserve bank"; but, at present, I think it would be advisable to ignore the practice and await further developments.

Respectfully,

Walter Wyatt,
General Counsel.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

X-5050-o

October 27, 1927.

Hon. Newton D. Baker,
Union Trust Building,
Cleveland, Ohio.

My dear Mr. Baker:

I enclose for your information a copy of a letter addressed to Governor Young under date of October 19th by Governor Wellborn of the Federal Reserve Bank of Atlanta, describing a new effort of certain banks in Alabama to avoid paying their checks at par by having their customers draw drafts on themselves payable through their local banks.

I have not yet had an opportunity to make any real study of this problem; but shall give you a mere off-hand expression of my views.

In view of the provision of Section 87 of the Negotiable Instruments Law to the effect that, "Where the instrument is made payable at a bank it is equivalent to an order to the bank to pay the same for the account of the principal debtor thereon," these drafts certainly have the same practical effect as checks; but it is doubtful whether they are technically checks. The Hardwick Amendment and the par clearance provisions of Section 16 relate to "checks and drafts" but we have generally assumed that the word "drafts" refers to "bank drafts" or checks drawn by one bank on another. I think, however, it might properly be construed to refer to "drafts" of the kind described above.

At any rate, this practice is a plain evasion of the par clearance provisions of the Federal Reserve Act, and I think we can find a way to stop it if it shows a tendency to spread. In this connection a recent decision of the British Courts might be very helpful. I understand that, in order to evade the payment of a tax on checks, the Midland Bank adopted the device of having their customers issue receipts in lieu of checks which receipts, however, passed from hand to hand and served the same purpose as checks. I understand that the Chancellor of the Exchequer ruled that these receipts or "chequelettes" were subject to the tax and that he has been upheld by the courts. The British Revenue Act, however, contains the following provision which is quite broad and could be construed to apply to these documents without the necessity of actually holding that they are checks:

> "For the purposes of this Act the expression 'bills of exchange' includes draft, order, cheque, and letter of credit, and any document or writing (except a bank note) entitling or purporting to entitle any person, whether named therein or not, to payment by any other person of, or to draw upon any other person for, any sum of money."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

I have found discussions of this question in the following British publications which you probably can obtain from the library of the Federal Reserve Bank of Cleveland, "The Banker", July, 1927, page 29; id. August, 1927, page 106: "The Financial News", June 3, 1927, page 5; and the "Statist", July 30, 1927, page 183.

One thing which bothers me is the fact that in our zeal to require all instruments handled by Federal reserve banks to be negotiable and to restrict the par clearance privileges to negotiable checks we have inserted as a foot note to Regulation J the following definition of a check:

> "A check is generally defined as a draft or order upon a bank or banking house, purporting to be drawn upon a deposit of funds, for the payment at all events of a certain sum of money to the order of a certain person therein named, or to him or his order, or to bearer, and payable on demand."

If we are to get around this practice and also the practice of avoiding par collection by making checks payable in New York exchange it might be advisable to consider the elimination or broadening of this definition. The Regulations have not yet been finally approved but probably will be acted on in the near future.

In this connection I might also advise you that Governor Young has some doubts as to the advisability of our proposed amendment to Regulation J requiring member banks and nonmember clearing banks to "cooperate fully in the system of check clearance and collection for which provision is herein made." I sincerely hope that when you are in Washington next week you can find time to talk to me for a few minutes about this.

I was in New York last week and gained the impression that some of the officers of the Federal Reserve Bank expect you to appear before the Governors' Conference to make a report regarding the method of handling checks. I told them it was my understanding that you were very busy with other matters and had not made arrangements to attend the Governors' Conference.

With kindest personal regards, I am

Very truly yours,

Walter Wyatt,
General Counsel.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis