

CRITICISMS AND SUGGESTIONS RE
ORIGINAL DRAFT (X-4878) OF REGU-
LATION ON NON CASH COLLECTIONS.

Federal Reserve Bank of Boston.

"For the present Regulation K, which would become new Regulation G, there would be substituted a new Regulation K, dealing with the collection of maturing notes and bills, that is, so-called non-cash items.

"The draft of the proposed Regulation which was submitted with the Federal Reserve Board's letter of June 21, 1927, in the main follows the structure of Regulation J, dealing with check collection.

"Section II of the proposed Regulation defines the maturing notes and bills which the Federal Reserve Banks may receive. The definition appears to include the bulk of the items which the Federal Reserve Banks are collecting. Paragraph 5 of Section II(a) appears, however, to be somewhat restrictive so far as the present practice of this bank is concerned. Paragraph 5 reads as follows:

'All other negotiable instruments payable in the United States, except checks, bank drafts, and other cash items which have not been previously dishonored.'

"It is the practice of this bank at the present time to receive drafts payable in South America, this bank handing the items to a Boston member bank which attends to collection and accounts to this bank for the proceeds. It is also the practice of this bank at the present time to receive for collection checks drawn on Canadian banks, the items being handed by this bank to Boston member banks who account to this bank for the proceeds.

"Section IV, items received for collection, is worded as follows:

'(a) Each Federal Reserve Bank will receive from its member and non-member clearing banks, for collection on the terms and conditions hereinafter prescribed, all items defined in Section II as "maturing notes and bills".'

If the above section were changed to read as follows, it would more nearly follow a similar section in Regulation J and perhaps more accurately express the real intent:

'(a) Each Federal Reserve Bank will receive from its member banks and from non-member clearing banks in its district, for collection on the terms and conditions hereinafter prescribed, "maturing notes and bills" as defined in Section II.'

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"Sub-section (b) of Section IV provides that each Federal Reserve Bank will receive from other Federal Reserve Banks and from all member banks and non-member clearing banks in other districts which are authorized to route direct for the credit of their respective Federal Reserve Banks, for collection on the terms and conditions herein-after prescribed, all items defined in Section II as 'maturing notes and bills'. The writer would suggest that the words 'items such as defined in Section II as "maturing notes and bills" which are payable within its district' be substituted for the words 'all items defined in Section II as "maturing notes and bills."'

"Sub-section (c) of Section IV provides that no Federal Reserve Bank shall receive for collection any item payable outside of the continental United States. This conflicts with the practice of this bank as mentioned above.

"Section V of the proposed Regulation outlines the terms of collection. Inasmuch as the circular letters of the Federal Reserve Banks now contain the uniform clause agreed upon by the Governors' Collection Committee with regard to guaranty of prior indorsements on collection items, would it be desirable to have this requirement reflected in the terms of collection promulgated by the Federal Reserve Board? This condition is embodied in our collection circular (Circular Letter F) as Section III, a copy of which is appended hereto.

"If it is decided to insert in Section V any provision with regard to the guaranty of prior indorsements as above suggested, the question then arises whether in paragraph 1 of Section V, covering the responsibility of the Federal Reserve Banks for due diligence and care in forwarding or presenting collection items, it would be desirable to add 'and its guaranty of prior indorsements'. If this were done, the condition would be similar to that contained in a like provision in Regulation J.

"Section VII of the proposed Regulation applies to charges for collection and paragraph 2 of sub-section (a) specifies that the actual expense of registration, insurance, or transportation of bonds and coupons forwarded to other points for collection, shall be deducted by the Federal Reserve Bank and credit given for the actual net proceeds. Would it not be well to change the proposed paragraph 2 so as to require such deduction 'as far as practicable' or "'when practicable' ? This inquiry is based upon the fact that the Federal Reserve Bank frequently receives the same kinds of items from many different sources, even in very small shipments, and later combines a lot of small items for shipment to some one point of collection. In such cases it is frequently not feasible to deduct the expense of registration, etc., from the proceeds of individual items.

"Sub-section (b) of Section VII provides that any member bank or non-member bank selected by the Federal Reserve Bank as an agent to collect maturing notes and bills received under the terms of the Regulation may make a reasonable charge for its services in handling such maturing notes and bills. Would it be desirable to specify in this sub-section that this shall not be construed as permitting any bank to make a charge for remitting for any check or draft when such check or draft is drawn on itself regardless of whether such check or draft is drawn on a savings or an ordinary demand account? This would reflect the principle established in the Board's ruling printed on Page 964 of the Federal Reserve Bulletin for October, 1919."

Federal Reserve Bank of New York.

"REGULATION K
SECTION II. DEFINITIONS

"3. Now reads -

'Checks, drafts and other cash items which have previously been dishonored.'

"It is suggested that this be changed to read: 'Checks, drafts and other cash items which have previously been dishonored, and checks, drafts and other cash items on which special advice of payment or dishonor is required.'

"5. Now reads -

'All other negotiable instruments payable in the United States, except checks, bank drafts, and other cash items which have not been previously dishonored.'

"It is suggested that this be changed to read: 'All other negotiable instruments payable in the Continental United States.'

SECTION VII. CHARGES FOR COLLECTION

"(a) Charges by Federal Reserve Banks

"(2) Now reads as follows:

'The actual expense of registration, insurance, or transportation of bonds and coupons forwarded to other points for collection shall be deducted and credit given for the actual net proceeds.'

"It is suggested that the underlined portion be changed to read as follows: 'shall be charged by deduction from the credit or otherwise.' This change is suggested for the reason that it is the practice with some of the Reserve Banks either to accumulate these charges and bill monthly, or to make separate charge.

"(b) Charges by Collecting Agents.

"It is suggested that the following be added to this paragraph: 'No charge shall, however, be made by any bank for a check drawn on itself or for its own acceptance.'"

Federal Reserve Bank of Philadelphia.

"Draft of proposed Regulation on maturing notes and bills (Regulation K, Section II)

"Section II- 3. If this proposed Regulation is to be incorporated, we would suggest that the words "and cash items on which special advice of payment or dishonor is requested" be added.

"Section II - 5. We would suggest that this be altered to read: 'all other negotiable instruments payable in the United States, except checks, bank drafts, and other cash items not included in Paragraph 3'.

"Section VII (third line). We would suggest the substitution of the words 'payment has been received' for the words 'a remittance'. It is the general practice in this District, and we believe in other Districts, to account for collection items by a notification reading 'Your account has credit today for the following collection', or 'We credit your account with collection', or 'We credit your account with collections paid', or 'You have credit for the following collections'. A notification of this sort is not technically a 'remittance', but is equally satisfactory, and in some cases more so.

"Section VII (b). We would suggest adding to this the words 'except their own acceptances and checks upon themselves'.

"It seems to us that (c) might be omitted. It seems unnecessary to suggest to a bank that it may make a charge against its own customers for services rendered by it to them, and we think it good policy to keep out, as far as possible, of relations between banks and their customers."

Federal Reserve Bank of Cleveland.

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The Federal Reserve Bank of Cleveland submitted the following suggestive revision of this regulation together with an explanation of the reason why it felt that changes in the proposed draft should be made:

(Note: Make this Regulation K; change old K to G; don't change designation of M.)

REGULATION K, SERIES OF 1927

COLLECTION OF MATURING NOTES AND BILLS

SECTION I. STATUTORY PROVISIONS

Section 13 of the Federal Reserve Act authorizes Federal reserve banks to receive from their member banks and non-member clearing banks, for collection, maturing notes and bills and to receive from other Federal reserve banks for collection maturing notes and bills payable within the district of the Federal reserve bank receiving such items. The authority to receive such items for collection includes the authority to take such steps and perform such acts as may be necessary to effect collection, and to exercise such other powers as are reasonably incidental to the collection of such items.

SECTION II. DEFINITIONS.

(a) Maturing Notes and Bills. The term "maturing notes and bills" is, for the purposes of this regulation, hereby defined to include the classes of negotiable instruments listed below, payable within the continental United States:

1. Maturing notes, drafts, bills of exchange, acceptances, bankers' acceptances, and certificates of deposit;
2. Drafts on savings accounts with pass-books attached;
3. Checks, drafts and other cash items which have previously been dishonored;
4. Maturing bonds and coupons; and
5. All other negotiable instruments except checks or bank drafts

drawn on or payable by non-member banks which have not agreed to remit at par therefor in funds acceptable to the collecting Federal reserve bank, provided that any Federal reserve bank may require any depositing member bank to show to such Federal reserve bank's satisfaction that special conditions exist which make it proper for said Federal reserve bank to handle for collection items of the character normally received by the Federal reserve bank as cash items.

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(b) NON-MEMBER CLEARING BANK. The term "non-member clearing bank" is defined to mean a non-member bank or trust company which maintains with the Federal reserve bank of the district in which it is located a balance sufficient to qualify it under Section 13 of the Federal Reserve Act to send cash items to the Federal Reserve Bank for purposes of exchange or collection under Regulation J

(c) CASH ITEMS. The term "cash items" is defined to mean negotiable instruments which are collectible pursuant to the terms of Regulation J.

(d) COLLECTION ITEMS. The term "collection items" is defined to mean those items which are collectible pursuant to the terms of Regulation K.

(The provisions of paragraph 5 of subdivision (a), Section II, have been changed in the following respects:

(a) The definition has been broadened to include checks, bank drafts, and other negotiable instruments normally handled as cash items, but the right is reserved to the Federal reserve banks to require the depositing banks to show that special conditions exist making it proper that what are normally cash items should be handled as collection items. It is, of course, true that it would be unreasonable for depositing member banks to require all items which would normally be handled as cash items to be handled as collection items, but it is also true that in some unusual cases where doubt exists as to the collectibility of a cash item same should be handled by the Federal reserve banks as a collection item. It is felt, therefore,

that it would be unwise for the regulation to exclude wholly from the category of collection items instruments of the character ordinarily handled as cash items except where such items have been previously dishonored. It is also felt that the provision inserted, reserving to the Federal reserve banks the right to require a showing that special conditions exist justifying the treatment of what is normally a cash item as a collection item, creates a safeguard against abuse of the collection facilities by the member banks.

(b) The definition in paragraph 5 is also narrowed to apply only to cases where the bank by which the item is payable has agreed to remit at par in funds acceptable to the Federal reserve bank undertaking the collection. This change obviates the necessity for the concluding unnumbered paragraph of subdivision (a).

It would seem that the definition as revised is more accurate and consistent with the uniform cash collection circulars of the various Federal reserve banks than is the draft submitted in the original of the proposed regulation.)

Subdivisions (c) and (d) have been added for the purpose of avoiding any question as to what "cash items" and "collection items" are under the terms of the Regulations.)

SECTION III. GENERAL REQUIREMENTS

The Federal Reserve Board, desiring to afford to the public and to the various banks of the country a direct, expeditious, and economical system for the collection of maturing notes and bills, has arranged to have all Federal reserve banks collect maturing notes and bills on a uniform basis and on the terms and conditions hereinafter prescribed.

SECTION IV. ITEMS RECEIVED FOR COLLECTION

(a) Each Federal reserve bank will receive maturing notes and bills from its member banks and from non-member clearing banks, in its district.

(b) Each Federal reserve bank will receive from other Federal reserve banks maturing notes and bills payable within its own district.

(c) In order to eliminate unnecessary delay and expense and further to increase the efficiency of the collection service herein provided, each Federal reserve bank will authorize all member banks and non-member clearing banks in its district to send maturing notes and bills for collection direct to the Federal reserve bank of the district in which such items are payable, for credit to the account of the Federal reserve bank of the district in which the sending bank is located.

(d) Each Federal reserve bank will receive from member banks and non-member clearing banks in other districts maturing notes and bills payable within its own district.

(e) No Federal reserve bank shall receive for collection any check or bank draft drawn on or payable by a non-member bank which cannot be collected at par in funds acceptable to the Federal reserve bank of the district in which such non-member bank is located, or any item payable outside of the Continental United States.

(The purpose of the changes made in the original draft of Section IV is to make effective a uniform practice with respect to the direct sending operations of collection items. While it may be true that the Federal Reserve Board does not legally have authority to require

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all Federal reserve banks to authorize all member and non-member clearing banks to send collection items direct to other Federal reserve banks, it is believed that if the Board states its policy to have such privilege given to all member and non-member clearing banks by the several Federal reserve banks, the reserve banks will conform to this policy and the Federal Reserve Board will then be in position of being justified in relying upon the presumption that the Federal reserve banks are authorizing all of their member and non-member clearing banks to send collection items to other Federal reserve banks. The risk of loss which may exist with respect to direct sendings of checks does not exist with respect to collection items because the receiving Federal reserve bank does not give advice of payment until it has actually received payment on the particular item.

The provision restricting collections to items payable in the Continental United States may render improper the collection of foreign items by a few of the Federal reserve banks, but it would seem that the provision restricting the non-cash collection function to the territorial limits of the System as it at present exists is sound and that the Board is justified in promulgating a regulation to confine these operations within this territory. This is consistent with the recommendation of the Governors' conference in October, 1922, record Volume 18, Part 1, Page 82.)

SECTION V. TERMS OF COLLECTION

The Federal Reserve Board hereby authorizes the Federal reserve banks to handle such maturing notes and bills subject to the following terms and conditions; and each member bank and non-member clearing bank which sends maturing notes and bills to any Federal reserve bank for collection shall by such action be deemed: (a) to have agreed to all the terms and conditions of this regulation; (b) to have warranted to the Federal

reserve banks that it has authority to empower the Federal reserve banks to handle items in the manner hereinafter provided; and (c) to have agreed to indemnify any Federal reserve bank for any loss resulting from the failure of such sending bank to have such authority.

1. Federal reserve banks will act only as the collecting agents of the sending banks and will be responsible only for due diligence and care in forwarding or presenting such items.

2. Federal reserve banks may present or forward such items direct to the banks on which they are drawn, at which they are payable, or through which they are collectible, for payment in cash, bank draft, or solvent credits; or present them direct to the person, firm or corporation on which they are drawn, for payment in cash or check; or, if the item is not payable in a city in which there is a Federal reserve bank or a branch of a Federal reserve bank, then they may, in their discretion, forward them to another agent with the same authority that they have to present or forward them for payment.

3. Items payable in another district will be forwarded to the Federal reserve bank of such district or to a branch of such Federal reserve bank for collection on the terms and conditions herein prescribed.

4. Except as herein provided, Federal reserve banks shall be held liable only when they have received actual payment in cash or in the final proceeds of any bank draft or check received in remittance.

SECTION VI. CREDIT FOR PROCEEDS

No Federal reserve bank shall credit the reserve account of any member bank or the account of any non-member clearing bank or any other

Federal reserve bank for the amount of any maturing note or bill until payment

in actually and finally collected funds has been received by the collecting Federal reserve bank. 236

(This paragraph is amended by slight changes in all language and the total elimination of the provision in the original draft that after credit, the collecting Federal reserve bank shall have the right in the event it does not receive payment in finally collected funds, to charge the reserve account or clearing account for the amount of the item. The language is also changed to mention accounts of Federal reserve banks because, in the direct sending operations, the account of the Federal reserve bank in whose district the item originated will be credited with the proceeds.)

SECTION VII. CHARGES FOR COLLECTION

(a) CHARGES BY FEDERAL RESERVE BANKS. No charge shall be made by any Federal reserve bank for the service performed by it in the collection of maturing notes and bills, except that:

1. Any charge made by another collecting agent shall be deducted and final credit given for the actual net proceeds;
2. The actual expense of registration, insurance, or transportation of bonds and coupons forwarded to other points for collection shall be deducted and final credit given for the actual net proceeds;
3. All telegraph and telephone charges in connection with the collection of maturing notes and bills shall be charged to the bank making the request involving such expense; and
4. A service charge of fifteen cents per item on all maturing notes and bills returned unpaid and unprotested shall be

charged to the bank from which such items were received for collection. This charge shall not be made on items that are protested.

- (b) CHARGES BY COLLECTING AGENTS. Any member bank or non-member bank selected by a Federal reserve bank as an agent to collect maturing notes and bills received under the terms of this regulation, may make a reasonable charge for its service in handling such maturing notes and bills; except that no such charge shall be made for handling checks and bank drafts.

SECTION VIII. OTHER RULES AND REGULATIONS

All Federal reserve banks shall also promulgate rules and regulations identical in terms, not inconsistent with the provisions of the law or of this regulation, governing the details of the collection of maturing notes and bills by such Federal reserve banks. Such rules and regulations shall be binding upon any member or non-member clearing bank which sends maturing notes and bills to its Federal reserve bank or any other Federal reserve bank for account of its Federal reserve bank.

(The language of this section has been changed to provide for uniform rules and regulations to be promulgated by all Federal reserve banks, consistent with the law and the Board's regulation, with respect to the details of collection of maturing notes and bills. It would seem that inasmuch as the non-cash collection function is to be exercised throughout the System, the details of administration prescribed by the Federal reserve banks should not differ in form or substance because:

1. In the event any litigation arises in which the rules and regulations prescribed by the banks are in question, a decision favorable to the rules and regulations prescribed by the Federal reserve banks will be beneficial to all banks equally if the provisions of the circulars of the several banks are identical, whereas if there is a difference in language, it may be questionable whether the decision of the Court will be beneficial to all the Federal reserve banks. If the decision is adverse, the change necessitated by it should be made in identical form in all circulars promulgated by the banks so that they will be equally protected against the possibilities of the adverse case;

2. For the purpose of clarity in administration, especially in view of the direct sending privilege, it would seem that the circulars should be identical in form;

3. It would seem that circulars identical in terms on the non-cash collection function are advisable because they would give to all banks the benefit of the combined thought of the officers of the different banks who are familiar with the non-cash collection problem, and should result in the preparation of a better circular than would be the case if each bank, individually, prepared its circular. It is suggested that the preparation of the uniform circular should be entrusted to the Standing Committee on Collection as that committee's members constitute, presumably, the best qualified representatives of the various banks to deal with this problem; and

4. A further reason for a uniform circular is that it would prevent inconsistencies in practice in the different Federal reserve districts which are confusing, not only to the member and non-member clearing banks, but to the officers and operating departments of the several Federal Reserve banks as well.)

Federal Reserve Bank of Richmond.

Referring to the Board's proposed Regulation K, Series of 1927, "Collection of Maturing Notes and Bills," the following changes are suggested:

SECTION II. DEFINITIONS

Change paragraph 3 to read: "Checks, drafts and other cash items which have previously been dishonored; and checks, drafts and other cash items on which special advice of payment or non-payment is desired."

Change paragraph 5 to read: "All other negotiable instruments payable in the Continental United States, except checks, drafts and other cash items which have not been previously dishonored or upon which no special advice of payment or non-payment is desired."

These changes are suggested because it is understood to be the general custom among reserve banks to handle checks, drafts and other cash items as non-cash items for collection at the request of member banks when special advice of payment or non-payment is desired, regardless of whether or not such items have previously been dishonored.

The collecting banks (agents), however, are not permitted to make a charge for their services in handling checks, drafts and other cash items, whether they have previously been dishonored or not, and therefore it would seem that Section VII (b) - "Charges by Collecting Agents" - should be changed, regardless of whether the above suggestions are adopted by the Board, by adding the following to that section appearing at the bottom of page five. The last clause regarding acceptances of member banks is in accordance with the Board's ruling XIII-B, 302.

"Provided, however, no such charge shall be made for handling checks, drafts and other cash items received under the terms of this regulation; and provided further, that no such charge shall be made by a member bank for handling its own acceptances."

It is also suggested that the last paragraph under Section II, appearing at the bottom of page one, be changed to read:

"The term 'maturing notes and bills' does not include checks, bank drafts, or other cash items which cannot be collected at par in funds acceptable to the collecting Federal reserve bank; that is, cash items drawn on or payable by non-member banks which are not on the par list issued by the Federal Reserve Board."

This will avoid the handling of checks on non-member non-par banks as non-cash items and the possibility of such banks' exacting an exchange charge on such items, which is prohibited under Section VII (b), as above revised. It will be noted that "certificates of deposit" have been omitted in revising the above paragraph, and it is also suggested that the words "or certificate of deposit" be omitted from Section IV (c) at the bottom of page two. The omission of "certificates of deposit" from these two paragraphs is suggested because it is understood that the Federal Reserve Board has ruled that a certificate of deposit is in effect a promissory note of the bank issuing it and may be received as a non-cash item for collection, and the issuing bank may therefore make an exchange charge when remitting for it. In view of this ruling certificates of deposit payable by non-member non-par banks are now handled by the Federal reserve banks as non-cash items for collection and should not be excluded in these paragraphs.

SECTION V. 3.

In accordance with the report of the Standing Committee on Collections to the Conference of Governors of November 12, 1923, Federal reserve banks are permitted to route drafts with documents attached, payable at sight or on demand, whether such drafts be purchased, discounted, or received for collection, direct to the point of payment in another district, when specifically requested to do so, and they are also permitted to route any collection item with a definite maturity direct to the point of payment when it is necessary to do so, in order that the item may reach the point of payment by maturity. It would seem that this paragraph should make provision for these exceptions by the addition of the following:

"Provided, however, that items with a definite maturity, payable in another district, may be forwarded direct to the place of payment in such other district when it is necessary to do so in order to reach the place of payment by maturity, and, further, that sight or demand drafts with documents attached, payable in another district, may be forwarded direct to the place of payment when the collecting reserve bank is specifically requested to do so."

SECTION VI. CREDIT FOR REMITTANCES

It is not the practice of reserve banks to pass credit for collection items until they have received actual and final payment in cash or in the proceeds of any bank draft or check received in remittance, as provided for in Section V. 4. The circular of this bank provides that "when remittance for a collection item is received in the form of a bank draft or check, credit will not be passed to the member bank's reserve account until such draft or check is actually collected." It is understood that this is the general practice among Federal reserve banks, and it would seem that section should be altered to meet the generally accepted practice (which is doubtless a sound one) and should simply read as follows:

"No Federal reserve bank shall credit the reserve account of any member or non-member clearing bank with the amount of any maturing note or bill until it has received actual payment in cash or in the proceeds of any bank draft or check received in remittance."

SECTION VII. (a) (2)

It is not always practicable to deduct the expenses mentioned in this paragraph in giving credit for the proceeds of such collections, and such costs are usually ascertained later and charged to the banks from which such collections were received. It is also the practice of at least one of the Federal reserve banks to accumulate such charges and make monthly charges to the accounts of member banks, with suitable statements. It is suggested, therefore, that this paragraph read:

"The actual expenses of registration, insurance, or transportation of bonds and coupons forwarded to other points for collection may be charged to the bank from which such bonds and coupons were received for collection."

The word "shall" in this paragraph has been changed to "may," because it is the practice of Federal reserve banks to absorb such expenses if they amount to less than twenty-five cents.

Federal Reserve Bank of Chicago.REGULATION K, SERIES OF 1927,
COLLECTION OF MATURING NOTES AND BILLS.

* * *

The proposed Regulation K appears to satisfactorily cover the non-cash collections function, with the following exceptions:

Section II, paragraph 5, construes the term "maturing notes and bills" to include "all other negotiable instruments payable in the United States, except checks, bank drafts, and all other items which have not been previously dishonored." Under this interpretation, checks received under special instructions, such as telegraph payment or non-payment, could not be handled as non-cash collection items. This paragraph directly conflicts with the uniform instructions in the check collection circulars of all Federal reserve banks which provide that, if any member bank should desire to have any checks handled by a Federal reserve bank under any instructions contrary to the uniform instructions, it will be necessary for such member bank to forward such checks as individual non-cash items with the instructions noted in the letter of transmittal, for collection and credit when paid, in accordance with the terms of our current Non-Cash Collections Bulletin.

I do not believe it was intended to change the present practice of handling checks under special instructions, and my opinion seems to be confirmed by paragraph (c), Section IV, of the proposed Regulation K which, by implication, provides for their handling, inasmuch as that paragraph excludes the handling of any check drawn on or payable by a non-member bank which cannot be collected at par in funds acceptable to the collecting Federal reserve bank. If, in Section II, paragraph 5, the words, "all other negotiable instruments payable in the United States," were added to the end of paragraph 4 and the remaining words of paragraph 5 were struck out entirely, the condition would be corrected.

In the next to the last line on page 1, the third word, "and," could be omitted with clarifying effect and make more definite the interpretation that "maturing notes and bills" does not include checks drawn on non-member banks which cannot be collected at par, etc.

Section VI provides that, upon receipt of a remittance in payment of a collection item, the Federal reserve bank will give credit in the reserve account of the member bank from which such item was received, subject to payment of such remittance in actually and finally collected funds. It is, at present, a requirement of the non-cash collection regulations that credit and advice of credit should not be given until receipt of payment in immediately available funds, and it is our view that this practice should be continued. We should not carry float on non-cash collection items and advice of payment should be definite and final, as at the present time. Under Section VI as it now stands,

Federal reserve banks would carry float and advice of credit could not be considered as definite and final.

Federal Reserve Bank of St. Louis.

July 9th, 1927.

MEMORANDUM TO MR. MARTIN:

I have gone over the proposed new Regulation on non-cash collections, which accompanied Federal Reserve Board letter X-4878, and have the following suggestions to offer:

Section II (a) 3 Should be changed to read: "Checks and drafts and other cash items which have previously been dishonored; and checks, drafts and other cash items on which special advice of payment or dishonor is required."

5 Should be changed to read: "All other negotiable instruments payable in the Continental United States."

The above changes are suggested for the reason that banks quite frequently desire to handle cash items on a non-cash basis, in order to obtain an actual advice of payment before passing credit to their customers.

Section IV (b). I would omit from the third line in this paragraph "are authorized to", for the reason that with one exception, all of the Federal Reserve Banks have given each other Federal Reserve Bank blanket authority to handle non-cash items received from all of their member banks or non-member clearing banks, and there appears to be no necessity for the receiving Reserve Bank checking to see whether the member bank or non-member clearing bank forwarding the item has authority. Such checking would result in unnecessary work, inconvenience and expense.

Section V 3. The Standing Committee on Collections, in its Report to the Conference of Governors, November 12th, 1923, recommended that Federal Reserve Banks be permitted, in their discretion, to route any documentary draft payable at sight or on demand, whether such draft be purchased, discounted or received for collection, direct to the point of payment in another District, but only when specifically requested to do so by the member bank selling, rediscounting or depositing for collection. This recommendation was approved by the Governors Conference. I, therefore, recommend that the paragraph under review be altered so as to provide for items payable in another District being forwarded direct to point of payment, either when the depositing bank requests that they be so forwarded, or it is necessary

to so forward an item in order that it may reach the point of payment on or before maturity.

Section V 2. As I interpret this paragraph, it would permit a Federal Reserve Bank forwarding non-cash items payable in the City in which it is located to other banks in such city for collection and remittance, which is the plan recently tried out by the Federal Reserve Bank of Minneapolis, and which caused so much disturbance.

Section VI. This paragraph, as drawn, makes credit conditional under certain circumstances. The Federal Reserve Bank of St. Louis never intentionally credits a collection until the proceeds are in actually collected funds. If an item is sent to an out-of-town bank and returns are received in St. Louis exchange, credit is given after the draft on St. Louis is actually collected. If returns are received in the form of exchange payable at some point other than St. Louis, credit is given after such exchange has been converted into actual funds on which there is no possible recourse. This part of the Regulation as drawn is apparently intended to permit credit being passed prior to a Federal Reserve Bank receiving final payment of the remittance received from a collecting agent, without liability on the part of the Federal Reserve Bank.

Section VII (a) 2 provides that expense other than collection charges be deducted when giving credit for the proceeds of a collection. This is rather impractical, and has been discussed at meetings of the Standing Committee on Collections, particularly in respect to telegraphic costs. To illustrate: Suppose the Federal Reserve Bank of St. Louis receives a collection from the Federal Reserve Bank of New York or one of its member banks payable at Evansville, Indiana, which is to be forwarded by registered mail and insured. The expense of registration and insurance would have to be held in suspense, awaiting returns on the collection, and then deducted from the returns received before crediting the net proceeds, whereas, following the usual procedure, the day the expense was incurred, or not later than the following day, a charge would go thru, and the accounting procedure would be ended. When an item is returned unpaid, there is nothing from which to deduct such expense, and the charge must necessarily be put thru in the manner described. Why delay putting it thru until the item has been paid or returned unpaid?

Section VII(b) would appear to permit the making of a reasonable charge for the collecting of checks and drafts drawn on banks which have previously been dishonored, and, if the suggestions I have made in respect to Section II were adopted, would permit a collection charge on any checks and drafts drawn on banks, which, of course, is inconsistent with the Act and Regulation J.

Very truly yours,

(S) C. M. Attebery,
Deputy Governor.

Federal Reserve Bank of Minneapolis.

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

Dear Governor Crissinger:

With further reference to the Board's letter x4878, dated June 21, 1927, regarding the proposed Regulation K, (Collection of maturing notes and bills), we advise that our Directors are still unanimously opposed to the handling of non cash collections, and have only consented to handle them the same as we did previous to February 1, 1927, for the sake of harmony and uniformity in the System. Our people feel that if we must handle them, we should be given more protection than the proposed regulations afford. For instance, we have before us at the moment a report upon a non member bank, the Pioneer State Bank of Glentana, Montana. This bank has been remitting to us at par willingly, but it does not do so promptly. In fact, at the moment they are eight days behind, and for over a period of a month the returns have been extremely unsatisfactory. We are today removing the bank from our par list.

According to the proposed regulations of the Board, if we should today receive a Bill of Lading draft on a concern in Glentana, Montana, we would be required to send such draft to the Pioneer State Bank of Glentana for collection, because there is no other bank at that point. If the draft was collected and the bank sent us a draft upon their correspondent in payment, which subsequently proved to be no good because the Glentana bank closed during the interim, we certainly would be guilty of gross negligence in handling the item, and could not possibly put up any reasonable defense. This is not an isolated case but a serious problem in our district, and has been for the past eight years. Certainly we should not be required to handle non cash items which we have to collect through a bank to which we will not send transit items.

In our present non cash collection circular, we protect ourselves by the following language:

"It (the Federal Reserve Bank of Minneapolis) reserves the right on receipt of any collection item payable at a place not on the Federal Reserve intra-district collection system list, to return the same without presentation".

Therefore if the regulation must be issued on non cash collection, we believe that we should be protected by some such clause as the above.

You will observe that in the proposed regulations of the Board, under (c) of (4) only checks, bank drafts or Certificates of Deposit are exempt, and not other non cash items. 247

If we have interpreted (2) under Section V (Terms of Collection) correctly, it means just this: If a firm in New York City draws a draft upon a firm in Minneapolis with negotiable securities attached, and such draft is received for collection by us from the Federal Reserve Bank of New York or one of its direct sending member banks, we can accept from the payer a bank check in settlement. If later it is discovered that the bank check is no good, we will be relieved of liability and the ultimate loser will be the drawer of the draft. When Mr. Wyatt was here the other day, he told me it was the impression of the Board that the Federal Reserve Bank would be protected under Section 6, because we would not pass credit to our endorser until we had actually collected such bank check. Nevertheless, the negotiable securities are out of our possession and in the hands of an irresponsible party, and the drawer of the draft would be out of luck. I do not believe that this is the kind of service that nine of the Federal reserve banks want to render to their member banks.

Furthermore, if we interpret the regulation correctly, a member bank or non member bank to which we send a draft with securities attached, could accept a bank check upon a competing bank in payment of such draft and deliver the securities. If such bank check subsequently proved to be no good and the member could not recover from the payer of the draft, such member bank would be relieved of liability. I do not believe that we want to give our member banks any such leeway.

The same would be true of drafts which we sent to other Federal reserve banks. We therefore believe that if Federal reserve banks in Federal reserve cities and branch cities want to collect drafts in such cities, they should assume complete responsibility for the collection of such drafts. In making this proposal, I am not unmindful of the great responsibility and the liability that I have mentioned many, many times before the Governors' Conferences. In reference to drafts payable outside of cities in which are located Federal reserve banks or branches, we believe that the Federal Reserve System is entirely justified in protecting itself by agreement, in accepting a draft in payment from our collecting agent, but we do not believe that agreement or regulation should permit our collecting agent to accept anything other than cash or its equivalent and assume complete responsibility and liability for collection.

I have repeatedly maintained that because of conditions which exist in the different districts, it is impracticable to attempt to put the handling of non cash items upon a uniform basis, and we still feel that it is unnecessary to issue a regulation in reference to the handling of non cash collections. We are sending herewith a copy of our Circular No.350, under which we have been operating, and under which we would prefer to continue to operate rather than by uniform regulation.

Yours respectfully,

(S)

R. A. Young
Governor

Federal Reserve Bank of Kansas City. -

"With reference to Regulation K, covering non-cash collections, I have this to say. As the Board well knows, inasmuch as this matter has been under discussion, I have persistently opposed the non-cash collection feature as it is now carried on, and in this opposition I have been unanimously supported by our board and the officers of this bank, and I sincerely believe that a great majority of the member banks of the Tenth District are in accord with our position. We believe it was not the spirit of the original Federal Reserve Act to have Federal reserve banks doing business on the street but to confine their activities to banks only.

"I have been intimately associated with corporations for more than forty years, and it has always been my desire, whenever it could be done consistently, to do the things that pleased our stockholders. That has been and is now the policy of this bank. I am confirmed in the belief that the majority of our stockholders are opposed to non-cash collections, as is evidenced by the questionnaires sent out and the replies received. I have attended the bankers' conventions in every state comprising the Tenth Federal Reserve District, and my reaction is as stated in the foregoing paragraph. Twice the American Bankers' Association has unanimously declared for revision of the non-cash collection system as it is now carried on. The above facts are what have controlled me in my action in this matter.

"Last September we were authorized by the Board that we might handle these non-cash items in such manner as we deemed best.

"If the Federal Reserve Board, in view of all I have recited, still believes that the present system of handling non-cash collections is right, the Federal Reserve Bank of Kansas City will bow to its mandate and carry on, but we wish to go on record as being opposed to the present system and believe that the plan proposed by the Federal Reserve Bank of Kansas City and the Federal Reserve Bank of Atlanta, copy of which was forwarded to the Board under date of December 13, 1926, by Chairman McClure, is a fair compromise and would meet the situation in a fair and just spirit.

Federal Reserve Bank of Dallas.

REGULATION K. (New.)

"We recommend that definition 5 under Section II be amended to read as follows:

'All other choses in action whether negotiable or not, payable in the United States, which the Federal Reserve Banks in their respective circulars may set forth.'

"Collection items are of various kinds and are frequently non-negotiable in character. To confine collection items to negotiable instruments would place an enormous burden upon each receiving Federal Reserve Bank in that the first duty would be to determine the negotiability of the instrument offered for collection. Therefore we think it would be utterly impossible to confine collection items to negotiable instruments. In addition the definition as set forth in this section are so limited in character that it would deprive the Federal Reserve Banks of the right to handle as collection items such instruments as bank drafts, checks with documents attached, etc.

"In actual practice we cut out in our Transit Department and handle through our Collection Department member banks' own drafts drawn on their correspondents and sent to us for credit, except those drawn on local banks, for the following reasons: First, we have in the past found several instances where two or more banks were kiting and we have found the handling of their drafts for collection to be an effective means for stopping this practice. Second, we have noted other instances where banks have attempted to create a balance with us by drawing against uncollected funds with their correspondents, hoping to cover them before the drafts are presented. If our cash letter containing these drafts should be delayed in the mail, or the items missent, we could very easily pay out the funds before we had any way of knowing that the drafts would not be paid. It is our opinion that cash letters are intended to include only miscellaneous checks which a bank receives in the regular course of business, and should not include a bank's own draft, or items of this character, and we see no reason why any hardship is being worked upon a member bank by refusing to handle their own drafts as cash items, as they will receive credit immediately upon actual payment, and if they wish to receive more prompt credit the wire transfer facilities are available.

"We also cut out of our Transit Department and handle through our Collection Department, checks with documents attached for the reason that we desire to avoid possible controversies in cases where documents might become detached. Our Collection Department makes a record of all attachments."

Federal Reserve Bank of San Francisco.

July 16, 1927.

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

Dear Mr. Wyatt:

The definition of maturing notes and bills appearing in my letter of July 11, 1927, contains an inhibition which is a little stronger than I had intended.

While it is not our practice to handle as non-cash collections bank drafts or other checks or certificates of deposit drawn on, payable at, payable through or payable by non-member banks which do not remit to the Federal Reserve Bank at par in acceptable funds in settlement of cash items, we do, however, very occasionally handle notes or other evidences of indebtedness which, by reason of their tenor, must be presented to a non-par bank for collection because there is no member or non-member par bank in the same town to which such items might be sent by us.

While it might be desirable for Federal Reserve Banks not to collect this character of items also, it would not seem desirable to change the existing practice without first submitting it for consideration to the Collection Committee and the Governors' Conference. No doubt in many districts the only restriction on dealings with non-par banks is to refuse to handle, either as cash items or as non-cash items, bank drafts or other certificates of deposit which must be presented for payment to non-member banks designated.

I should like, therefore, to modify the recommendation contained in the letter hereinabove mentioned, as follows:

REGULATION K, Section II. The following is suggested:

Section II, Definition A, Maturing Notes and Bills.
The term "maturing notes and bills," for the purpose of this Regulation, has been construed and is hereby defined as

including notes, drafts, bills of exchange, acceptances, bankers acceptances, bonds, warrants, coupons, bank drafts

or other checks or certificates of deposit and all other evidences of indebtedness payable in the continental United States;

but the term shall not include

bank drafts or other checks or certificates of deposit drawn on, payable at, payable through or payable by banks or trust companies which do not remit to the Federal Reserve Bank at par in acceptable funds in settlement of cash items.

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It is also recommended that Section IV (c) be changed to read:

"No Federal Reserve Bank shall receive for collection bank drafts or other checks or certificates of deposit drawn on, payable at, payable through or payable by banks or trust companies which do not remit to the Federal Reserve Bank at par in acceptable funds in settlement of cash items."

Yours very truly,

(S) Ira Clerk
Deputy Governor.

Federal Reserve Bank of San Francisco,-

"REGULATION K, Section II. The following is suggested:

Section II, Definition A, Maturing Notes and Bills. The term 'maturing notes and bills,' for the purpose of this Regulation, has been construed and is hereby defined as

including notes, drafts, bills of exchange, acceptances, bankers acceptances, bonds, warrants, coupons, checks, certificates of deposit, and all other evidences of indebtedness payable in continental United States;

but the term shall not include

notes, drafts, bills of exchange, acceptances, bankers acceptances, bonds, warrants, coupons, checks, certificates of deposit, or other evidences of indebtedness, drawn on, payable at, payable through or payable by, banks or trust companies which do not remit to the Federal Reserve Bank at par in acceptable funds in settlement of cash items.

No purpose can be seen in making specific mention of drafts on savings banks with pass book attached, as these are already covered as drafts hereinabove; nor in making specific mention of checks and drafts and other cash items which have previously been dishonored, particularly when this classification, by inference, eliminates checks which have not previously been presented. It is quite a common custom for banks to forward for collection checks or bank drafts as special items that represent collections for which the collecting bank will not part with funds to their customers until actual final settlement has been received therefor.

The word 'maturing' has been purposely left out in these recommendations because it might imply that the maturity of a bond, note, etc. must be immediately pending, whereas it is quite proper, and indeed common, for a bank to forward such items to their points of payment weeks or even months before maturity.

In paragraph 5, particular mention is made, in the Board's proposal, of negotiable instruments. As a large quantity of promissory notes, etc. which are received for collection are non-negotiable, it does not seem desirable or necessary to refuse to handle such instruments; nor is it practicable for reserve banks to examine collections in order to determine whether or not they are negotiable. So-called 'pay checks', for instance, used by firms to settle

wages of laborers, are nothing more than receipts when executed for payment. Drafts of many railroads are not negotiable. Nevertheless, these and numerous other classes of credit instruments are collected through banking channels. As an extreme case, might be mentioned meal tickets issued by one of the Departments of the United States Government, and received by this bank for collection.

The last paragraph of Section II, subdivision (a), pertaining to checks, bank drafts or certificates of deposit drawn on or payable by non-member banks, will be eliminated if the foregoing suggestion be accepted. If the suggestion, however, be not accepted, the paragraph should be changed because it carries the inference that the Federal Reserve Banks require non-member banks to remit in settlement of certificates of deposit in available funds at par. As you will recall, the Federal Reserve Board has ruled that certificates of deposit are not acceptable by Federal Reserve Banks as cash items, and, inasmuch as certificates of deposit must necessarily be handled as special collection items, it would not seem desirable to impose upon non-member banks the requirement that they shall remit at par for their own certificates of deposit, when not collectible as a cash item. A special collection needs special service, and, while the act of charging for such collections merely because they must be specially handled, is not condoned, longdrawn-out disputes with member banks on this point have been avoided because of the feeling that the primary interest of this bank is in collecting non-member-bank checks at par.

Section IV(c) provides that no Federal Reserve Bank shall receive for collection any check, bank draft, or certificate of deposit, drawn on or payable at a non-member bank which cannot be collected at par in funds acceptable to the Federal Reserve Bank. If the suggestions hereinabove mentioned are not adopted, it is suggested that the language be changed to read as follows:

'No Federal Reserve Bank shall receive for collection, notes, drafts, bills of exchange, acceptances, bankers acceptances, bonds, warrants, coupons, checks, certificates of deposit, or other evidences of indebtedness, drawn on, payable at, payable through or payable by, banks or trust companies which do not remit to the Federal reserve bank at par in acceptable funds in settlement of cash items. '

"This would be in harmony with the present practice of not having any dealings with non-member banks the items of which cannot be collected at par in funds acceptable to Federal reserve banks.

"Section V, paragraph (1). The following change is suggested.

"1. Federal reserve banks will act only as the collecting agents of the sending banks and will be responsible only for due diligence and care in ~~forwarding~~ presenting such ~~items~~ and effecting collection of such items.

"The slight change in the language is intended to cover the responsibility of a Federal reserve bank for collecting checks or drafts which have been handed or remitted to it in lieu of settlement of collection items. It is not uncommon to forward an item to an out-of-town bank and to receive in settlement a draft drawn on the bank's correspondent at still another point, which draft in turn has to be collected before surrendering the proceeds of the collection to the depositing bank. The term 'presenting and effecting' would seem to be sufficiently inclusive to carry the operation to its completion.

"Section V, paragraph (3). This paragraph provides that Federal Reserve Banks must forward items payable in other districts to the Federal reserve bank of that District. This, of course, is impracticable, particularly if the point at which the item is payable is closer to the Federal reserve bank of the district in which the item originates and the maturity of the instrument is so short as not to permit sending the item first to the Federal reserve bank of the other district. It is suggested that this paragraph be changed to require member and non-member clearing banks to forward items payable in another district direct to the Federal reserve bank or branch of that district, except where the element of time makes this impracticable because of the short maturity of the collection, in which event they may be deposited with the Federal reserve bank of the district for collection through the most expeditious channel. The Regulation should not prohibit a Federal reserve bank sending items for collection direct to banks in other districts. It is a lack of economy for the System to have the same collection handled by two separate Federal reserve banks. Member and non-member clearing banks, therefore, should be required (except in special cases in which the element of time is involved) to forward items payable in another district or zone to the nearest Federal reserve bank or branch. It became necessary for the Federal Reserve Bank of San Francisco to require its banks to direct-route collections in order to avoid what was regarded as an unnecessary expense. In the case of coupons, the expense of handling both by this bank and another Federal Reserve Bank appeared unjust to the System, and by requiring direct-routing the expense was cut in half.

"Section VI. The Regulation provides that, upon receipt of a remittance in settlement of a collection item, the Federal reserve banks will give credit in the account of the bank from which the item was received, subject to final payment. It is not the practice of this bank to give credit for collections until final funds have been received. It is obvious that a bank which forwards an item for collection does not wish

to receive credit except in such form that it can safely pass the funds to its customer without the possibility of later having to part with them because the collection had been incomplete when settlement was made with its customer. It is recommended that this provision be eliminated from the Regulation.

"Section VII, paragraph (a), subdivision (2). It is suggested that in view of the definition of 'maturing notes and bills,' contained in Section IIA, this paragraph be changed to read:

"The actual expense of registration, insurance or transportation on maturing notes and bills forwarded to other points for collection shall be deducted and credit given for the actual net proceeds."

"Frequently notes and drafts are supported by securities and documents which should be forwarded by registered mail, and sometimes also insured.

"Section VII, paragraph (a), subdivision (3). It is suggested that this subdivision be changed as follows:

"All telegraph and telephone charges in connection with the collection of maturing notes and bills shall be charged to the bank ~~making the request involving such expense~~ for which the collection is made; and

"Frequently it becomes necessary for the protection of both the Federal reserve bank and the bank for which the collection is being made, to incur telegraphic expense in connection with collections. If a refund by the Federal reserve bank can only be made when the expense is incurred at the request of the bank for which the collection is being made, it may leave room for argument as to whether or not the expense, in the light of subsequent facts, was justified. The Federal reserve banks should be left free to use their discretion in effecting collections and have the right to recover cost of justified expenses whether or not incurred at the request of the depositing bank.

"Section IX. Guaranty of Endorsement. Inasmuch as it has been pointed out that large quantities of items are received for collection which are not negotiable, it seems important to require that the depositing bank guarantee all prior endorsements of notes, drafts, bills of exchange, acceptances, bankers acceptances, warrants, checks, certificates of deposit, and all other such evidences of indebtedness which require endorsement in order to effect collection.

"You will recall that it was agreed in the conference with the Board in December, 1924, that all Federal reserve banks should require items lodged for collection to bear the endorsers' guarantee of all prior endorsements, and that if the endorsement upon an item did not include a written or printed guaranty of all prior endorsements, the act of sending the item to a Federal reserve bank would be deemed to constitute such guaranty. Inasmuch as the Federal reserve banks have this provision embodied in their operating circular, the Board may not desire to incorporate in its Regulations. It is mentioned, however, for consideration