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X-5060

January 4, 1928.

Mr. H. F. Strater, Cashier,
Federal Reserve Bank,
Cleveland, Ohio.

Dear Mr. Strater:

Pressure of other work has prevented me from replying more promptly to your letter of November 23rd with regard to criticisms of the proposed Regulation K governing non-cash collections submitted by Messrs. Ira Clerk, Deputy Governor of the Federal Reserve Bank of San Francisco, and Mr. A. C. Agnew, their Counsel. I hope you will pardon the delay.

As you know, the Board has decided not to adopt a regulation on non-cash collections, but to leave the matter to be covered by uniform circulars on this subject to be prepared by your Committee, as suggested by the Governors' Conference. This leaves the matter in your very capable hands and I am perfectly content to let it rest there. As you know, the proposal to issue a regulation on non-cash collections was not initiated by me but by the Federal Reserve Board itself and I have never felt that such a regulation was essential. I believe that the subject can be covered equally as well in a uniform circular. If I can be of any assistance to your Committee in preparing such a circular, I shall be very happy to do so, but I hope that you will not feel constrained to consult me on the subject merely out of politeness, unless you think I can be of some real assistance.

With all best wishes for a very happy and prosperous New Year, I am,

Cordially yours,

Walter Wyatt
General Counsel.

Copy X-5060-a

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FEDERAL RESERVE BANK

OF CLEVELAND

November 23, 1927.

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

Dear Mr. Wyatt:

I am very sorry that pressure of other work has prevented my replying to your letters of November 10 and 11, enclosing copies of communication received by you from Mr. Ira Clerk, Deputy Governor of the Federal Reserve Bank of San Francisco, and Mr. A. C. Agnew, their counsel, bearing upon the proposed Regulation K governing the handling of non-cash collections.

I have given careful consideration to both of the letters from San Francisco, and in view of the action taken at the last Governors' conference when it was recommended that no regulation on non-cash collections be issued and your conversation and mine with Governor Young on the proposed terms of collection incorporated in the tentative draft of Regulation K, it seems to me that the terms of collection incorporated in the proposed uniform non-cash collection circulars of the twelve reserve banks could very well be modified to fix responsibility for the use of due diligence only on the Federal reserve banks. This would dispose of Mr. Clerk's objection to the use of the phrase "solvent credits" and Mr. Agnew's objection to the same phrase coupled with "bank drafts", and would permit the Standing Committee on Collections to frame a section covering the terms of collection to be uniformly used by all of the Federal reserve banks which would take care of the necessity of establishing the relationship of principal and agent in the handling of these items.

With respect to Mr. Clerk's reference in his letter to you of November 1, to the contemplated use of a special endorsement by a member bank on non-cash collection items, I believe his recommendation that the form of endorsement to be used by member banks on all non-cash items deposited with any Federal reserve bank or branch for collection, be definitely prescribed in the check collection circular and provisions made in the circular that any other form of endorsement will be disregarded.

It seems to me that there should be added to the language suggested by Mr. Clerk, a provision warranting the member bank's authority to waive its rights which might accrue through endorsements bearing special instructions, conditions, or qualifications, and to agree to indemnify any Federal reserve bank for any loss resulting from the failure of the depositing bank to have such authority. This would be in accordance with a similar provision in Regulation J.

I have not as yet heard what the Federal Reserve Board has decided to do in connection with the issuance of a new regulation on non-cash collections, but if it is decided that such a regulation be issued, I shall be very much in favor of modifying the terms of collection so as to harmonize with Governor Young's views which I believe to be perfectly sound. I shall be very much interested in knowing the Board's decision on this question inasmuch as if the Board approves the recommendation of the Governors' conference that a uniform non-cash collection circular be prepared by the Standing Committee on Collections, it is essential that the committee begin to work on the preparation of such a circular at the earliest possible moment so that it may be presented as a finished product to the next conference.

I hope that my views as expressed to you in this letter, do not reach you too late to be of any value to you.

Very truly yours,

H. F. Strater,
Cashier.

Copy

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FEDERAL RESERVE BANK OF SAN FRANCISCO

November 5, 1927.

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

Dear Mr. Wyatt:

I have read carefully and with a great deal of interest the two very illuminating articles transmitted with your letter of October 26, being extracts from the Virginia Law Register furnished through the courtesy of Mr. Steadman, the editor of that publication.

The articles referred to are the best resumes of the law on that subject I have seen and will be of great value in the preparation of briefs involving the subject covered. I am, as you may perhaps remember, in sympathy with the position taken by Mr. Harris in his article, inasmuch as I have always felt that the doctrine of the Peters case is contrary to the reason and principle of our law. I have, however, been seeking an opportunity to establish the theory of that case in the states of this district.

The perusal of these articles prompts me to recall to your attention a matter mentioned in a letter, dated November 1, 1927, addressed by Mr. Clerk, one of the Deputy Governors of this bank, to you. In the letter referred to Mr. Clerk calls to your attention the provisions of paragraph 2 of Section V of the revised draft of Regulation K, Series of 1927 (X-4915-a), wherein the new regulation provides that collection items may be forwarded for payment in cash, bank draft, or solvent credits.

It seems to me that it even is more essential to preserve, so far as possible, the relation of principal and agent in the handling of collection items than in the handling of cash items. The authorities cited by both Mr. Bryan and Mr. Harris seem to draw a very clear distinction between those cases in which the forwarding bank has transmitted the items with the understanding that the proceeds thereof were to be intermingled with the general assets of the collecting bank and those cases where the items are forwarded merely for collection and remittance, and having been collected, the proceeds thereof are, in violation of contract, intermingled with the general assets of the bank and credit given in the form of a draft or otherwise. In the first class of cases the courts quite generally hold that the action of the bank which forwards the items in consenting that the proceeds be intermingled with the assets of the collecting bank constitutes a consent to the establishment of the relation of debtor and creditor and prevents the establishment of a preference, while in those cases where the items are forwarded for collection and remittance, the collecting bank is held to be a constructive trustee for the proceeds of the collection.

Therefore, it seems to me that if the Federal reserve banks expressly reserve the right to forward collection items for payment in cash, bank draft, or in solvent credits, this constitutes an implied consent to the establishment of the relationship of debtor and creditor and even in such states as Virginia and Missouri, would prevent the establishment of a preferred claim where a settlement was made under the recirpocal account method. Would it not, therefore, be better to reword paragraph 2 of Section V of the new regulation to read as follows:

> "Federal reserve banks may present or forward such items direct to the bank on which they are drawn and at which they are payable, or through which they are collectible, for collection and remittance; or present them direct to the person, firm, or corporation on which they are drawn, for collection and remittance; 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. Such forms of remittance as are customarily accepted by other banks in settlement for collection items may be accepted by Federal reserve banks."

I realize that the foregoing leaves indefinite the specific kind of remittance which Federal reserve banks are authorized to accept, but it seems to me that this uncertainty is preferable to the use of terms which carry with them notice and consent to the establishment of the relation of debtor and creditor.

I submit the foregoing merely for your consideration.

Yours very truly,

(Signed) Albert C. Agnew
Counsel.

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FEDERAL RESERVE BANK OF SAN FRANCISCO

November 1, 1927.

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

Dear Mr. Wyatt:

In reviewing rather hastily the revised draft of Regulation K, Series of 1927, (X-4915-a), several ideas have occurred to us which you may desire to consider before making the final draft of this regulation.

SECTION II. DEFINITIONS

In paragraph 5 we suggest inserting "or non-member clearing Bank", making the paragraph read as follows:

> ***provided that any Federal reserve bank may require any depositing member bank or non-member clearing bank to show to such Federal reserve bank's satisfaction ***etc.

SECTION IV. ITEMS RECEIVED FOR COLLECTION

Paragraph (c) provides that Federal reserve bank may authorize member and non-member clearing banks to direct route to other Federal reserve banks in order to eliminate unnecessary delay and expense. It would seem that for this same reason Federal reserve banks should have the option to require direct routing if the volume of transactions warrants it. Wherever we have had a material volume of items we have asked our member banks to direct route them and in all cases, but one, have received the fullest cooperation. The one bank declining has a large volume of coupons payable in New York; that bank has refused to direct route in the absence of a specific ruling requiring it. Its failure to direct route imposes a double expense upon the Federal Reserve System and , in addition, gives the dissenting member bank the advantage in the matter of shipping costs over those banks which have agreed to cooperate with us.

SECTION V. TERMS OF COLLECTION

Recently it came to our attention that a member bank contemplated placing a special endorsement on its items forwarded to the Federal reserve bank for collection, as follows:

"For collection and remittance without deposit or intermingling with the Bank's funds."

To remove the additional responsibility which would be placed upon the Federal reserve bank as a consequence of such endorsement, we contemplated inserting in our revised Circular 101, covering the collection of non-cash items, the following provision:

> All items received and sent forward for collection will be forwarded under indorsement of this bank substantially as follows:
>
> "Pay to the order of any bank, banker, trust company, or Federal Reserve Bank for collection only. Prior indorsements guaranteed."
>
> This bank does not undertake to procure for the owners of items entrusted to it for collection any greater rights than those accorded by law under the foregoing indorsement. Items bearing indorsements containing special instructions, qualifications, or conditions, will be forwarded by this bank as aforesaid, and banks sending them to this bank, and prior indorsers, will be deemed to have waived any rights which might accure through indoresements bearing such special instructions, conditions or qualifications.

Inasmuch as the proposed Regulation K. reguires all Federal reserve banks to promulgate rulse and regulations indentical in terms, you may de sire to give consideration as to whether this provision should be incorporated in such regulation. It appears to us as a matter of particular importance,

Paragraph 2 of Section V, provides that items may be forwarded for payment in cash, bank draft, or solvent credits. The thought has occurred to us that the use of "solvent credits" would imply that the Federal reserve bank may forward items to member and non-member clearing banks for collection and CREDIT. While it is true that Federal reserve banks accept solvent credits in settlement of collections, it would seem preferable not to ask for such form of payment for fear that the credit given may not prove to be solvent and the Federal reserve bank may find itself in the position of having asked for credit and thereby having act up the debtor and creditor relationship which experience has shown it was desirable to avoid. (Colo. & So. Ry. Co. v. Docking - 124 Kans. 48:257 Pac. 743.)

Yours very truly,

(Signed) Ira Clerk
Deputy Governor.

X-5060-d

Copy

August 8, 1927

MEMORANDUM FOR MR. MARTIN:

As requested, I have studied the revised draft of Regulation K, Series of 1927, X-4910, which you brot back with you from Washington. I have the following comments and suggestions to make:

Section V. 1, provides that Federal Reserve Banks ***** will be responsible only for due diligence and care in forwarding and presenting such items ********.

The effect of paragraph 2 is not entirely clear to me. For instance: Supposing a draft on an individual or firm, with bill of lading or securities attached, is forwarded by a Federal Reserve Bank to a commercial bank in another city for collection and returns. The collecting bank presents the draft to the drawee for payment and delivers the draft and documents upon payment in the form of a check of the drawee on its account in a local bank. The check develops to be no good, and there is a loss. The collecting bank can show that it was justified in accepting the check, in that it had no reason to believe that the drawer was not good, and as a matter of fact might be able to indicate that it had on numerous occasions accepted checks of the same maker, all of which were promptly paid. Under the circumstances, would the collecting bank have exercised due diligence and be relieved from the more or less established rule that results in responsibility for accepting payment in a form other than cash?

Now, let us take the case of an item payable in a Federal Reserve Bank or Branch Bank City, where presentation is made by the Federal Reserve Bank or Branch and not thru another bank. Under circumstances similar to those enumerated in respect to where an item is handled thru another bank, would a Federal Reserve Bank or Branch have exercised due diligence?

It occurred to me that these two paragraphs might permit and encourage the acceptance of checks both on the part of the Federal Reserve Banks as well as collecting agents they may select, when the acceptance of such checks is unwise from a credit standpoint, and doubtful from the standpoint of having exercised due diligence.

Memorandum to Mr. Martin. 8/8/27

Paragraph 4 provides that "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". The fact that the terms "bank draft or check" are used in this paragraph leaves the impression that it applies both to remittances received from collecting agents as well as remittances received from payers where personal presentation is made by the Federal Reserve Bank.

I am thoroly in accord with the idea that the Regulation should provide for the acceptance of remittances in the form of bank draft of collecting agents along the same lines as is followed in the check collection system, but I do question the desirability of the Regulation authorizing Federal Reserve Banks to accept checks in payment of collections where the Federal Reserve Bank makes the presentation direct, or the authorization of a similar practice on the part of collecting agents they may select. I do not believe that such authorization in the Regulation would have the effect of relieving Federal Reserve Banks or the agents they select from negligence in accepting checks, and I am of the opinion that if member banks using the collection system understood that the Federal Reserve Banks were trying to contract or successfully contracting against such negligence, the System's value to them would be considerably reduced.

In paragraph 2, first line, the words "or forward" suggest to me the possibility of Federal Reserve Banks turning over local items to member or non-member banks for collection along the lines recently tried out in Minneapolis.

Section VII, paragraphs 2 and 3 apparently make it optional with each Federal Reserve Bank whether the actual expense of registration, insurance or transportation and all telegraph and telephone charges in connection with the collection of maturing notes and bills are recovered from the bank which deposits such items. The question of uniformity again crops up. As worded, the Federal Reserve Bank of St. Louis would be permitted to waive such items of expense and at the same time, the Federal Reserve Bank of Chicago or any other Federal Reserve Bank might adopt the opposite practice, and the question is immediately raised - Why is one Federal Reserve Bank more liberal than the other? At the present time, the Federal Reserve Bank of St. Louis does not absorb any telegraph and telephone charges in connection with the collection of maturing notes and bills, nor does it assume the actual expense of registration, insurance or transportation of maturing notes and bills forwarded to other points for collection when the cost exceeds 25¢

Very truly yours,

O. M. Attebery,
Deputy Governor.

Copy X-5060-e 365

July 25, 1927.

Mr. F. J. Zurlinden, Deputy Governor,
Federal Reserve Bank of Cleveland,
Cleveland, Ohio.

My dear Mr. Zurlinden:

I enclose for your information and for such further criticism and comment as you may care to submit a revised draft of the proposed regulation on the collection of maturing notes and bills. This draft was prepared after consideration of the various suggestions submitted by the other Federal reserve banks and is based upon the draft prepared by the Federal Reserve Bank of Cleveland. I shall indicate briefly the reasons for the various changes which I have made in the Cleveland draft:

Section II. A slight change is made in the first paragraph to improve the phraseology. The change in subdivision (a) 3 was suggested by several of the other Federal reserve banks and is believed to be desirable. In subdivision 5 the words "evidence of indebtedness" have been inserted in lieu of the words "negotiable instruments", because several Federal reserve banks pointed out that non-cash items very frequently are non-negotiable and that it would be burdensome on the Federal reserve banks to undertake to determine whether or not such items are negotiable. Similar changes are made in subdivision (c) and (d) for the same purpose.

SectionIV. I have inserted in subdivision (a) the words "payable in the continental United States" to distinguish this from the items handled under (b) and (c) which must be payable in the district of the receiving Federal reserve bank. I have combined subdivision (c) and (d) and believe that I have improved the language somewhat without changing the meaning.

Section V. Owing to suggestions made by several Federal reserve banks, I have incorporated in the first paragraph of this section a provision for the guarantee of all prior indorsements; and, at the end of subdivision 2, I have added the words "and for its guarantee of prior indorsements". The change made in subdivision 3 was suggested by several different Federal reserve banks to cover the situation where it is desirable for items payable in other districts to be forwarded direct to the place of payment instead of being forwarded to the Federal reserve bank of such other district.

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Section VII. The language of subdivisions 1 and 2 has been changed so as to make it possible either to charge the bank from which such items are received or to deduct the charge from the proceeds and give credit for the actual net proceeds. In subdivision 2 the words "maturing notes and bills" have been substituted for the words "bonds and coupons" because it was suggested that the words "maturing notes and bills" are broad enough to include"bonds and coupons" and also broad enough to include "notes and bills" to which bonds and coupons are attached and which should be registered or insured. In subdivision 3 the words "from which such items were received" have been inserted in lieu of the words "making the request involving such expense" because it was suggested that very often telegraph and telephone charges must be incurred without any specific request having been made, and that such charges should be collected from the sending banks even though such banks did not make any request involving such expense. Subdivisions 2 and 3 have also been made permissive and not mandatory because it was suggested that the banks may wish to waive expenses amounting to less than 25 cents.

I am submitting this to you informally because I have not had an opportunity to submit to the Board and because I desire to obtain your further comments and criticisms at the earliest possible date. I do not know when the Board will take up the regulations for final approval but if it should decide to take them up this week I may call you on the telephone to obtain your further comments and criticisms regarding this regulation.

Thanking you and the other officers of the bank for your kind assistance in this matter, and with all best wishes, I am,

Cordially yours,

Walter Wyatt,
General Counsel.

Enclosure.
WW MD

Copy X-5060-f

FEDERAL RESERVE BANK OF ST.LOUIS

June 28, 1927.

Dear Mr. Strater:

Replying to your letter of the 25th, I have carefully gone over Regulation K, as submitted by the Federal Reserve Board with its letter X-4378, bearing date of June 21st. I have the following comments or suggestions to offer:

Section II, (a), 3 and 5, would seem to preclude our handling as a collection checks or drafts drawn on banks unless such items have been previously dishonored. I imagine the practice of all of the Reserve Banks is to handle checks and drafts on banks for collection when special advice of payment is desired, irrespective of previous dishonor. I would, therefore, suggest that No. 3 be eliminated, and that No. 5 be made to read: "All other negotiable instruments payable in the United States".

Section IV, (b). At the present time, I believe all of the Federal Reserve Banks, with the exception of Minneapolis, have given other Federal Reserve Banks blanket authority to handle non-cash items received from all of their member banks and non-member clearing banks. If this authority is continued, the wording of this paragraph will not up-set things, but if it becomes necessary, as a result of the way in which this paragraph is now worded, for each Federal Reserve Bank to furnish each other Federal Reserve Bank with a list of the member and non-member clearing banks authorized to route direct, and for the Federal Reserve Banks receiving collections from banks in other Districts to check such collections to see whether they are from banks that have authority to route direct, it will result in what I consider unnecessary work, inconvenience and expense. I would suggest that in the third line "are authorized to" be omitted.

Section IV, (c). As you are aware, we now handle for the account of the Treasurer of the United States checks drawn on banks which we do not know whether can be collected at par. Possible the fact that such items are handled only for the Treasurer of the United States makes no difference so far as the Regulation is concerned. I have, however, thot it well to mention the matter, in order that it might not be overlooked.

Section V, 2. I am not so sure about the possibilities under this paragraph. Would it permit a Federal Reserve Bank to follow the plan recently inaugurated by Minneapolis?

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, in my judgment, a proper one, and I think the paragraph under review should 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 by maturity.

Section VI. This is the most important Section in the Regulation. It is the custom in this District to expect that credit covering the proceeds of a collection is final; and I think this is the general custom thruout the Country. This paragraph, as drawn, makes credit conditional. The Federal Reserve Bank of St. Louis never knowingly credits a collection until the proceeds are in actually collected funds. If we send an item to an out-of-town bank and receive returns in St. Louis exchange, credit is given after the draft on St. Louis is actually collected. If we receive returns in the form of exchange on some other point, credit is only given after such exchange has been converted into actual funds on which there is no possible recourse. The same is true of local collections handled by our four offices - credit is never intentionally passed until we know we have the money. I would strongly recommend that this paragraph be worded so as to meet the practice just described.

Section VII, (a), 2 suggests that expense other than collection charges be deducted when giving credit for the proceeds of the collection. This is rather impractical, and I believe has been discussed at previous meetings of the Standing Committee on Collections - particularly in respect to telegraphic costs. To illustrate:

Suppose the Federal Reserve Bank of St. Louis received a collection from the Federal Reserve Bank of Cleveland payable at Evansville, Indiana, which is to be forwarded by registered mail and insured. The expense of registration and in-

surance 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 moment the expense was incurred, that is, the day the item was forwarded or not later than the following day, a charge would go thru and the accounting procedure would be ended, so far as the expense was concerned. 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 I have just described.

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 other Regulations.

Very truly yours,

O. M. Attebery,
Deputy Governor.

OMA:S

Mr. H. F. Strater, Chairman,
Standing Committee on Collections,
Federal Reserve Bank of Cleveland,
Cleveland, Ohio.