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# FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO  
THE FEDERAL RESERVE BOARD

X-6124

September 4, 1928.

**SUBJECT:** Topic for Joint Conference - Minimum maturity on member bank collateral notes.

Dear Sir:

There is enclosed herewith copy of a memorandum from the Board's General Counsel submitting and commenting upon a proposed amendment to the Board's regulations which would fix seven days as the minimum limitation on advances by Federal Reserve Banks to member banks on their promissory notes secured by eligible paper or Government securities. Such an amendment has been suggested as a possible means of preventing day to day borrowings by member banks for the making of loans of a speculative character, and the Board has voted, before acting upon the suggestion, to refer it to the forthcoming conference of the Governors and Federal Reserve Agents for discussion and recommendation, as well as to the fall meeting of the Federal Advisory Council.

Very truly yours,

E. M. McClelland,  
Assistant Secretary.

TO ALL GOVERNORS AND  
FEDERAL RESERVE AGENTS.

June 21, 1928.

To Federal Reserve Board  
From Mr. Vest, Assistant Counsel.

SUBJECT: Minimum maturity of seven days  
on member banks' collateral  
notes.

In accordance with the Board's request there has been prepared and is attached hereto a draft of an amendment to the Board's regulations which would fix seven days as the minimum limitation on advances by Federal reserve banks to member banks on their promissory notes secured by paper eligible for rediscount or by bonds or notes of the United States.\*\*\*

Some question may be raised as to the Board's authority to prescribe a regulation of this kind. In my opinion the Board has the authority under the law to do this if it so desires.

Section 13 of the Federal Reserve Act contains the following paragraph:

"The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board."

This provision obviously gives broad authority to the Federal Reserve Board in the matter of regulating the discount and purchase of paper by Federal reserve banks. The term "bills receivable" includes promissory notes, bills of exchange or other instruments for the payment of money. (see WORDS AND PHRASES and Bouvier's LAW DICTIONARY.) This provision of law, therefore, makes the discount of any promissory note by any Federal reserve bank subject to such restrictions, limitations and regulations as may be imposed by the Federal Reserve Board. The broad authority to impose any restrictions and limitations thus given in my opinion empowers the Board to prescribe a minimum limitation on maturity of notes discounted by a Federal reserve bank.

The word "discount" according to the decided cases applies not only to the purchase of a note from one who actually owns the same, i.e., the payee or the holder, but also includes the transaction by which the loan is made to the maker of a note by the payee thereof. See Fleckner v. Bank, 8 Wheat. 338; National Bank v. Johnson, 104 U.S. 271; Esten v. Third National Bank (Ky.), 42 S.W. 1115; and Morris v. Third National Bank (C.C.A.) 142 Fed. 25. In this connection it may be well to mention the fact that the same amendment to the law, that of September 7, 1916, which authorized Federal reserve banks to make advances on member banks' collateral notes, also inserted the words "discount and" in the above quoted paragraph of Section 13. This may be regarded as of some significance as to the intention of Congress.\*\*\*

I am, therefore, of the opinion that the above quoted paragraph of Section 13 confers upon the Federal Reserve Board the authority to prescribe limitations and restrictions on advances by Federal reserve banks to member banks on their collateral notes and that this authority is broad enough to empower the Board to prescribe seven days as a minimum

limitation for advances of this kind.

It may be regarded as questionable whether this proposed limitation on maturity of member banks' collateral notes is in harmony with the purpose of Congress in providing that Federal reserve banks may make advances to member banks on their promissory notes with maturities up to fifteen days. The following is a quotation from a letter addressed by the Governor of the Federal Reserve Board to Senator Owen in 1916 recommending the passage of this amendment:

"The Board has recommended in the amendment designed to provide for 15-day loans, that member banks be permitted to put up as collateral paper of the kind they can now rediscount, or Government bonds in which they can now invest, and to obtain very short term loans based thereon. Experience has shown that in many cases where a bank would gladly obtain accommodation for a limited time, it does not care to go to the trouble of rediscounting paper for a specific period of maturity, although it would probably take advantage of an opportunity to obtain temporary accommodation if it could do so without having to borrow for the full period of the note's maturity, or otherwise comply with restrictions or limitations that may be deemed onerous. It is, therefore, recommended that the member banks be permitted to obtain of Federal reserve banks short period loans of this kind."

It seems apparent from this that it was contemplated that member banks might borrow on their promissory notes for very brief periods, even as short as one or two days.

As stated above, however, in my opinion the Board has the authority under the law to prescribe this limitation if it deems it advisable.

Respectfully,

(signed) George B. Vest,  
Assistant Counsel.

(COPY)

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(Proposed new section of Regulation A to be inserted as Section X of Article A, subsequent sections to be renumbered accordingly.)

SECTION X. ADVANCES TO MEMBER BANKS ON THEIR PROMISSORY NOTES.

(a) Any Federal reserve bank may make advances to any of its member banks on their promissory notes provided such notes are secured by such notes, drafts, bills of exchange or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of the Federal Reserve Act or of the Regulations of the Federal Reserve Board, or are secured by the deposit or pledge of bonds or notes of the United States.

(b) No such advances shall be made for a period exceeding fifteen days nor for a period less than seven days. A note of a member bank given for any such advance in no case shall be cancelled or marked paid or shall be returned to the member bank until payment in full of both principal and interest thereof shall have been made not less than seven days after the advance to the member bank. No rebate of interest covering any part of such seven-day period shall be made in any case.