FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

June 27, 1929
St. 6248

Dear Sir:

At the last Governors' conference, consideration was given to topic III-D "Redemption Fund for Federal reserve notes. Is there any need for two separate funds?" and the conference voted that the Chairman appoint a committee to confer with the Treasury officials and express the opinion of the conference that an effort should be made to do away with the Federal reserve agents' redemption fund if agreeable to the Treasury. The secretary of the Governors' conference has since advised me that the Chairman appointed Mr. L.R.Rounds of the Federal Reserve Bank of New York and myself as the committee to confer with the Treasury officials.

For your information, I am enclosing a copy of a memorandum dated March 28, 1929 with reference to this subject which explains the history of the two separate redemption funds and the use made of them by the several Federal reserve banks which, it will be noted, is not uniform.

Information now available indicates that ten of the Federal reserve banks make cross entries between the agent's redemption fund and the bank's redemption fund in connection with all shipments of mutilated Federal reserve notes to the Treasury by them or by other Federal reserve banks for their account while two of the banks make no entries whatever in their redemption funds in connection with such shipments. These banks merely reduce on their own books the amount of Federal reserve notes outstanding. If the procedure followed by these two banks is adopted by the other ten the only Federal reserve notes which will be charged to the redemption fund by the Treasury will be those received from sources other than the Federal reserve banks and such redemptions can be accomplished through the bank's redemption fund as easily as through the agent's redemption fund. It would seem from the above that there is no occasion for the maintenance of the two separate redemption funds and the elimination of one would not only simplify somewhat the accounting procedure incident to the retirement of Federal reserve notes but would also make it necessary to show only one redemption fund in published reports, thereby removing a source of confusion to many students of the System.

Since the suggestion for the discontinuance of one of the redemption funds was first made another very practical reason has developed which seems to make the change desirable. Under the procedure followed by a majority of the banks, transfers are made between the two funds upon receipt of notice from the Treasury that Federal reserve notes have been received for retirement. This necessitates maintaining a close watch on the amounts of the respective redemption funds in order that there may be at all times a sufficient balance to effect the redemptions. In view of the impending change in the size of the currency, several of the Federal reserve banks have thought that some change of procedure would be necessary in order that the more rapid retirement of Federal reserve notes which is anticipated following July 10 can be made without building up too large a redemption fund and thus possibly depleting the reserves against deposits. The procedure suggested is as follows:

1st - That with the approval of the Secretary of the Treasury, the agents' redemption funds be closed and all Federal reserve notes presented to the Treasury for redemption be redeemed out of the banks' gold redemption fund. This, of course, would be done with the understanding that if at any future time circumstances should arise making desirable the maintenance of such funds, the Secretary would request the Federal Reserve Board to require each agent to reestablish his fund.

2nd - That the procedure incident to the retirement of Federal reserve notes be as follows:

a - That each Federal reserve bank charge to an account entitled "Mutilitated Federal reserve notes forwarded for redemption" all notes of its issue forwarded to Washington either by itself or by another Federal reserve bank for its account. (This is identical with the present procedure).

b - That upon receipt of advice from the Treasury that notes shipped by the bank or by another Federal reserve bank for its account have been received in Washington entries be made debiting "Federal reserve notes outstanding" and crediting "Mutilitated Federal reserve notes forwarded for redemption" thus accomplishing the retirement of the notes with a minimum amount of bookkeeping. This procedure would, of course necessitate the Federal reserve agents reducing on their books the amount of Federal reserve notes outstanding. It would not require entries in the redemption funds on the books of the Federal reserve agents, the Federal reserve banks or the Treasury of the United States.

The proposed change in procedure has already been discussed informally with the Treasury and our committee would like to have your advice as promptly as possible as to whether or not the proposed plan has your approval. If the plan meets with the approval of the agents, the matter will be taken up with the Treasury formally with a view to having the necessary instructions issued at the earliest practicable date.

Very truly yours,

E. L. Smead, Chief,
Division of Bank Operations.

LETTER TO ALL FEDERAL RESERVE AGENTS*

Enclosure.

March 28, 1929

Mr. McClelland SUBJECT: Redemption funds against Federal reserve notes.

Mr. Smead

With regard to topic III.-D on the program for the next Governors' Conference "Redemption fund for Federal reserve notes. Is there any need for two separate funds?" I wish to comment as follows:

Section 16 of the Federal Reserve Act provides that the Board shall require each Federal reserve bank to maintain on deposit in the Treasury of the United States a sum in gold sufficient in the judgment of the Secretary of the Treasury for the redemption of the Federal reserve notes issued to such bank, but in no event less than 5 per cent of the total amount of notes issued less the amount of gold or gold certificates held by the Federal reserve agent as collateral security. The same section also provides that upon the request of the Secretary of the Treasury the Federal Reserve Board shall require the Federal reserve agent to transmit to the Treasurer of the United States so much of the gold held by him as collateral security for Federal reserve notes as may be required for the exclusive purpose of the redemption of such Federal reserve notes. It is apparent from the above that the Act requires the Federal reserve banks to maintain a gold redemption fund with the United States Treasurer for the redemption of Federal reserve notes but that the maintenance of an agents' gold redemption fund is discretionary with the Secretary of the Treasury.

Under date of January 24, 1916, Mr. McAdoo, then Secretary of the Treasury, requested the Board to require each Federal reserve agent to transmit gold equal to 5 per cent of the amount of notes against which gold had been deposited with him, to the Treasury of the United States for the exclusive purpose of the redemption of such notes. The establishment of redemption funds by the agents was necessary at that time as a number of the Federal reserve banks had deposited gold with the agents in an amount equal to the total amount of Federal reserve notes outstanding and therefore were not required to maintain a gold redemption fund with the United States Treasury. From experience during the past several years there does not seem to be much prospect that any Federal reserve bank will in the future deposit gold with the agent equal to the amount of Federal reserve notes outstanding and consequently it is worthwhile to review the use made of each of the redemption funds in order to ascertain whether the two funds are necessary or desirable.

The present method of redeeming Federal reserve notes I understand to be as follows: When Federal reserve notes are returned to the Treasury for redemption by a Federal reserve bank, other than the bank of issue, settlement between Federal reserve banks is made in the gold settlement fund clearing. Upon receipt of notice from the Treasury that such Federal reserve notes have been received and package counted the Federal reserve

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banks and agents of New York and Chicago merely reduce on their books the amount of Federal reserve notes outstanding. In the case of the other ten banks the United States Treasurer charges the redemption fund of the agent and credits the redemption fund of the bank with the amount of notes received, and corresponding entries are made by the bank and agent in their redemption funds, and in addition they reduce the amount of Federal reserve notes outstanding. When notes are sent to the Treasury by the bank of issue the Treasurer, in the case of nine of the banks, charges the redemption fund of the agent and credits the redemption fund of the bank for the amount of shipment. In the case of the New York and Chicago banks the Treasury merely notifies the bank and the agent of the receipt of the shipment and they make the necessary entries to reduce the amount of Federal reserve notes outstanding. In the case of the San Francisco bank the Treasury notifies the Federal Reserve Board of the receipt of the shipment and the Board charges the agent in the gold fund and credits the bank in the gold settlement fund.

In all of the above cases the work would be simplified materially and a considerable amount of bookkeeping made unnecessary if all banks handled the entries the same as do the Federal Reserve Banks of New York and Chicago.

The only other redemptions of Federal reserve notes are the relatively small amounts which find their way into the Treasury mostly through banks in Washington. It is the present practice of the Treasury to charge these notes to the agents' gold redemption fund and this is the only purpose for which the redemption fund of the Federal reserve agent at New York is used. These redemptions could very well be made out of the bank's gold redemption fund.

From the above it would seem that there is now no real occasion for the maintenance of two separate redemption funds. If one of the funds is to be eliminated it would, under the Federal Reserve Act, have to be the agents' fund and as the elimination of such fund would simplify materially the number of entries required at the Treasury and the Federal reserve banks its elimination would seem to be desirable.

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