FEDERAL RESERVE BOARD

X-6409

WASHINGTON

November 7, 1929.

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

SUBJECT: Topic for Governors' Conference:- Interpretation of Uniform Policy re Check Collections.

Dear Sir:

There is enclosed for your information a copy of a letter addressed to the Board by Governor Harding raising the question whether the uniform policy on check collections set forth in the Board's letter of October 16, 1929 (X-6389) should be construed as preventing a Federal reserve bank from making special arrangements to secure the payment of checks in special cases and particularly whether it would be inconsistent with the uniform policy for a Federal reserve bank to take a pledge of collateral for the specific purpose of protecting itself as agent in the collection of checks on a specific bank. There is also enclosed for your information a copy of a letter on this subject which the Board's General Counsel is addressing to counsel for all Federal reserve banks, discussing the question briefly and requesting each of the counsel to advise the Governor of his Federal reserve bank of his views on this question prior to the Governors' Conference.

The Board has voted to place on the program for the forthcoming Governors' Conference the specific question raised by Governor Harding's letter, i.e., whether it would be inconsistent with the uniform policy, which has received the approval of the Federal Reserve Board, for a Federal reserve bank to take a pledge of collateral for the specific purpose of protecting itself as agent in the collection of checks on a specific bank.

By order of the Federal Reserve Board.

Very truly yours,

E. M. McClelland,
Assistant Secretary.

Enclosures.

TO GOVERNORS OF ALL F. R. BANKS.

C O P Y

X-6409-a

November 7, 1929.

Dear Sir;

I enclose for your information a copy of a letter addressed to Governor Young by Governor Harding with reference to the Board's letter of October 16, 1929 (X-6389), announcing the Board's approval of the uniform policy to be pursued by Federal reserve banks in asserting rights on behalf of depositors of unremitted for transit items against receivers of insolvent member banks. You will observe that Governor Harding raises the question upon which the eight counsel voting for this uniform policy split by a vote of five to three, i.e., the question whether it would be contrary to the uniform policy for a Federal reserve bank to make special arrangements to secure the payment of checks in special cases, (See page 5 of the Minutes of the Conference of Counsel) and particularly whether it would be inconsistent with the uniform policy for a Federal reserve bank to take a pledge of collateral for the specific purpose of protecting itself as agent in the collection of checks on a specific bank.

The Federal Reserve Board has placed this specific question on the program for the forthcoming Governors' Conference, and I believe it would be advisable for counsel for each of the Federal reserve banks to advise the Governor of his Federal reserve bank of his views on this question. Before doing so I respectfully suggest that counsel for each Federal reserve bank, including those who voted against the majority report, consider this question anew on its merits without being prejudiced by his vote at the Conference of Counsel, with a view of possibly obtaining greater unanimity of thought on this specific question than it was possible to obtain during the hasty consideration of this point during the closing moments of the Conference of Counsel. I make this suggestion in view of the fact that counsel voting against the majority resolution have not recorded their views on this question at all, and it is possible that some of the five counsel voting against the proposed amendment reserving the right of Federal reserve banks to take special steps to protect themselves in specific cases, may have done so not because they were opposed to any such practice on principle but because they believed it was unnecessary and unwise to amend the resolution so as expressly to reserve such right.

When this question arose during the Conference of Counsel, I expressed the off-hand opinion that the resolution adopted by the majority counsel would preclude acceptance of collateral for this purpose. That view was based upon the statement in paragraph 6 of the resolution that "any deviation from this policy" would entail grave dangers to the Federal Reserve System and was influenced by the personal belief that it would be a dangerous practice to accept collateral in some instances and not in others.

After a closer study of the resolution, however, I am now of the opinion that it would not contravene the terms of the resolution for a Federal reserve bank in a specific case to accept a separate deposit of collateral for the specific purpose of protecting itself as agent in collecting checks; because the 4th paragraph of the resolution refers only to collateral taken from a member bank "for the payment of indebtedness due to it by such member." I believe, however, that, whenever a Federal reserve bank takes collateral to protect it in its capacity of a collection agent, (1) such collateral should be taken under a special collateral agreement expressly providing that it is pledged to the Federal reserve bank in its capacity as a collection agent to protect it against losses in such capacity only, and (2) such collateral should at all times be kept separate and distinct from any collateral taken to secure any indebtedness owing to the Federal reserve bank in its own right. I further believe that any arrangement by which the same collateral is taken to secure indebtedness owing to the Federal reserve bank in its own right and at the same time to protect it against losses in its capacity as a collection agent or which otherwise would produce any confusion or conflict between the selfish interests of a Federal reserve bank and its duties as a collection agent would be a clear violation of the uniform policy.

On the question of policy, I am still of the opinion that there is some danger in a Federal reserve bank being held guilty of negligence for failure to take such collateral in a particular case when it can be shown that it has taken such collateral in other cases; but I personally believe that this will result in less danger to the Federal reserve banks than would a rigid rule preventing them from taking any special steps to protect themselves in collecting checks on banks in a precarious financial condition. In other words, I think the practical considerations stated by Governor Harding outweigh the danger of loss resulting from the taking of greater precautions in some cases than in others.

In conclusion, permit me to suggest that in my personal opinion it would be unprofitable at this time to enter upon a further

discussion of the principal points considered at the last Conference of Counsel, as a uniform policy with respect thereto has not only been adopted by the Conference of Governors but has now been approved by the Federal Reserve Board.

With kindest personal regards, I am

Very truly yours,

Walter Wyatt,
General Counsel.

TO COUNSEL OF ALL F. R. BANKS.

COPY X-6409-b

FEDERAL RESERVE BANK

OF BOSTON

October 19, 1929.

Hon. R. A. Young, Governor,
Federal Reserve Board,
Washington, D. C.

Dear Governor Young:

I have before me the Board's letter of October 16, 1929 (X-6389) with reference to a uniform policy on check collections and amendments to Regulation J, and I note that the Board has voted to approve the principles set forth in the resolution and report adopted by a majority of the counsel of all Federal Reserve Banks at the conference held in Washington on April 1 and 2, 1929.

As indicated by our Counsel, Mr. Weed, at the Conference of Counsel, and by me at the joint meeting of the Governors with the counsel of all the Federal Reserve Banks, we are heartily in agreement with the general principles that there should be no attempt to "superimpose upon a pure agency status any indicia of ownership with respect to the subject matter of the agency". We are likewise in agreement with the principle laid down in the amendment of Paragraph 6 of Section V of Regulation J recommended by counsel and set forth in the Board's letter of October 16 to the effect that neither the owner nor the holder of an unpaid check shall have any right of recourse upon, interest in, or right of payment from, any fund, reserve, collateral, or other property of the drawee bank in the possession of the Federal Reserve Bank.

For the sake of the record, however, and in order to make sure that our practice shall be in agreement with the policy and principles set forth in the Board's letter of October 16, it seems to me that I should offer a comment with reference to a part of the resolution of counsel and thus determine whether our interpretation of the policy laid down in that resolution and in the amendments of Regulation J is correct.

At the time the resolution and report was adopted by a majority of the counsel, Mr. Weed, Counsel for this bank, stated that he voted for the report with the understanding that it was not intended to carry with it any implication that a Federal Reserve Bank may not make special arrangements to insure the payment of checks in special cases. His reservation had particular reference to Paragraph 4 of the resolution reading as follows:-

"4. When a Federal reserve bank takes from one of its members collateral for the payment of indebtedness due to it by such member, such collateral should be applicable only to the satisfaction and discharge of the obligations due to the reserve bank in its own right. It would be an unwise policy, in our opinion, to permit such collateral to be utilized in the liquidation or satisfaction of debts payable to the Federal reserve bank as a collection agent."

In other words, in voting for the adoption of the report, our counsel took the position that Paragraph 4 of the resolution had reference to collateral taken by a Federal Reserve Bank for the payment of indebtedness due to the Federal Reserve Bank in its own right and had no reference to any separate or special agreement under which collateral might be pledged with the Federal Reserve Bank in its capacity as agent. Later when the Governors met with the Conference of Counsel, I raised the question whether the policy outlined in the resolution would prohibit our making special arrangements in special cases, and the answer made to me by the spokesman for the majority of counsel was that the resolution would not prohibit special arrangements to insure the payment of checks in special cases.

Naturally therefore we interpret the resolution and the amendments to Regulation J, as set forth in the Board's letter of October 16, in the light of the discussion which took place at the conference, but inasmuch as the point is not covered in the letter it would seem to be in order to verify our understanding as to what we may do under the policy approved by the Board. I sincerely hope that our interpretation may be considered consistent with that policy.

To begin with, each Federal Reserve Bank must receive from its member banks and from other Federal Reserve Banks checks drawn upon any of its member banks. Federal Reserve Banks must therefore attempt to collect checks drawn on any member bank in their districts, either by presenting them direct or through other banks. Legally I suppose there is no reason why presentment could not be made through other banks but obviously if such a course were pursued it might tend in many cases to invite comment and bring about bank suspensions which could otherwise be ultimately avoided. In the case of checks drawn on non-member banks we are, it is true, not under the same legal compulsion to receive them as we are in the case of checks drawn on member banks, but as a practical banker and a student of the operation of the Federal Reserve System, I do not see how we can avoid accepting from our member banks and from other Federal Reserve Banks checks drawn on any par-remitting bank in the district which is open and apparently solvent. If we were to refuse to accept such checks, we might again bring about unnecessary and undesirable results. It seems to me therefore that as a practical matter we must

receive for collection checks drawn on any bank in our district as long as there is a chance to effect collection and that we must avoid so far as possible collection of checks by indirect methods.

If it is a reasonable conclusion that acting as agent for others we must accept checks for collection, then it seems to me we must be permitted to protect ourselves against any liability as agent, and if I construe the Federal Reserve Act correctly, there is nothing in the Act to prevent our safeguarding ourselves against agency liabilities or to prevent our protecting our principals.

This would also seem to be consistent with the general rule which permits a competent agent to perform acts which are ordinarily within the scope of the agent's principal. I believe that banking practice for years before the enactment of the Federal Reserve Act established the right of a bank holding for collection checks drawn on a second bank to require the drawee bank to establish a fund or pledge collateral with the collecting bank to insure the payment of such items. Several collecting banks may unite for such a purpose and either through clearing house associations or otherwise ask for collateral from certain drawee banks to insure the payment of checks. I think therefore that there can be no reasonable question under general principles of law as to the right of a Federal Reserve Bank acting as agent for a group of banks, - its member banks and other Federal Reserve Banks, - to take collateral from individual drawee banks under special agreements in which such collateral is pledged to the Federal Reserve Bank as agent.

I am offering this comment not because I consider argument necessary but because it seems to me vitally important that there should be no question as to the right of a Federal Reserve Bank to protect itself as agent, and my statement is made principally that the record may be clear. Inasmuch as we construe the policy set forth in the resolution of the majority of counsel and the amendments of Regulation J as having reference to collateral received by a Federal Reserve Bank in its own right only, that is as principal, our conclusion, for the reasons I have given, is that the Board's letter of October 16 was not intended to prevent any Federal Reserve Bank's making special arrangements to protect itself as agent; in other words collateral pledged with the Federal Reserve Bank in its own right is one thing and is within the scope of the Board's letter of October 16, while collateral pledged with the Federal Reserve Bank as agent is another thing and not covered by the Board's ruling or amendments of Regulation J. I do not know whether it is legally necessary for Paragraph 6 of Section V to recognize this distinction but it does seem essential that the distinction shall be recognized in the record.

I should be obliged if you would let me know whether our interpretation is in the opinion of the Board consistent with the policy outlined in the Board's letter of October 16 and the amendments of Regulation J contained in that letter.

Very truly yours,

(S) W. P. G. Harding,
Governor.

A.