COPY

X-6428

November 11, 1929.

Mr. E. R. Black, Governor,
Federal Reserve Bank of Atlanta,
Atlanta, Georgia.

Dear Mr. Black:

Mr. Wyatt has sent me a copy of the letter of October 19, 1929, written to Governor Young by Governor Harding, with reference to the propriety of the taking by a Federal Reserve Bank of deposits of collateral for the protection of itself against any liability, as agent, arising from the handling for collection of checks drawn on the bank depositing such collateral. Mr. Wyatt, in transmitting the copy of the aforesaid letter, suggests that I write you with reference to the questions raised thereby.

Inasmuch as you also have a copy of Governor Harding's letter, I shall not summarize the same here. I am, however, sending you a copy of Mr. Wyatt's letter, thinking it possible that no other copy of the same has been furnished you.

I am of the opinion that the taking of collateral in isolated cases, for the purposes and under the conditions stated in Governor Harding's letter, would be consistent with the uniform policy heretofore adopted by the Conference of Governors and now approved by the Federal Reserve Board. There is nothing stated in the Board's letter of October 16, 1929 (X-6389) which would prohibit a Federal Reserve Bank, which is unwilling to handle checks drawn upon a bank of doubtful solvency unless it be indemnified against any loss in the premises, from asking and taking such collateral. It seems to me, furthermore, that unless the practice of asking collateral for such purpose is made general (as distinguished from the asking of security in particular cases), the question of policy is one for determination by the different Federal Reserve Banks. I know that Governor Harding has in mind only the asking of collateral in cases where it appears that the interests of the Federal Reserve Bank of Boston require the taking of such security. As I recollect the statement made by Mr. Weed, counsel to the Boston Bank, before the Conference of Counsel, but one instance had arisen in the past where collateral had been asked by that bank. I see no reason, therefore, why Governor Harding's interpretation of the Board's statement of the uniform policy on check collections should not be accepted as correct.

Undoubtedly a question of system wide importance would be raised were any Federal Reserve Bank to either (a) adopt a general policy of requiring collateral from banks for the indemnification of the Federal Reserve Bank against liability as a collection agent, or (b) provide by contract that collateral in its hands should stand as security for <u>any</u> indebtedness due to the Federal Reserve Bank by the pledgor, including amounts due to the Reserve Bank as a collection agent. As stated above, however, no such question is raised in Governor Harding's letter as I read it.

Personally, I am inclined to the opinion that the interests of the Federal Reserve Bank of Atlanta would be best served by a policy under which collateral would not be asked, even in cases where items are to be sent to banks known to be in a doubtful condition. The taking of collateral in one case, without requiring it in another, would furnish the basis for at least an inference of negligence in the latter case. In this Reserve District, furthermore, the number of non-member par remitting banks is relatively small. Demands for collateral to protect items sent forward for payment and remittance would tend to curtail the number of par remitting banks. Member banks in a failing condition are usually largely indebted to the Federal Reserve Bank and they could rarely furnish acceptable collateral for the purpose of protecting remittances for cash letters without utilizing security which the Reserve Bank would wish to obtain for its own benefit.

The experience of the Atlanta bank in its collection functions has been fortunate. I recall no claim for negligence in the handling of items which has been successfully asserted. The public generally is beginning to recognize the fact that Federal Reserve Banks, as collection agents, have stipulated for their own protection within proper limits. I believe it to be the better policy to continue in the future as in the past, and to regard the duties of a mere collection agent as not including any obligation, either legal or moral, to obtain security for the protection of its principals. I understand, of course, that the taking of such collateral would be for the protection of the Reserve Bank, as agent, but inevitably the owners of the items would feel that it was in reality taken for their benefit and the tendency of the practice would doubtless be to foster the conception of a duty on the part of the agent to secure collateral protection for its principal.

Very truly yours,

(S) Robt. S. Parker.

RSP/w.

Copy to:

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

COPY

X-6428-a

FEDERAL RESERVE BANK OF RICHMOND

Mr. George J. Seay, Governor. November 15, 1929.

M. G. Wallace, Counsel. Interpretation of Uniform Policy re Check Collections.

Dear Mr. Seay:

I have read the attached letter dated November 7th from Mr. E. M. McClelland, Assistant Secretary of the Federal Reserve Board, to yourself and also the letters which are referred to by Mr. McClelland. It is not quite clear to me whether or not the Federal Reserve Bank of Boston desires to take collateral merely to protect itself from liability in case it should be held that the Federal Reserve Bank was responsible to the depositors of checks because such checks had been sent to the drawee bank when the latter was known to be in a weakened condition, or whether the Federal Reserve Bank of Boston desires to take collateral to protect the depositors of checks from losses which might otherwise fall upon its depositors.

If the object of the arrangement be as first stated, I am of the opinion that the arrangement would be in no way inconsistent with the recent amendments to Regulation J, because the collateral taken would in no way benefit the banks which deposited the checks or the holders of the checks but would be held merely for the protection of the Federal Reserve Bank in the event that it should appear that the Federal Reserve Bank had been guilty of negligence.

There would be certain practical objections, I believe, to such a practice. In the first place the very fact that the Federal Reserve Bank had taken collateral to protect it against a possible claim for negligence would be tantamount to a confession that the Federal Reserve Bank realized that its actions were likely to be considered negligent; also, it would be impossible to determine when the lien of the Federal Reserve Bank upon such collateral terminated because the Federal Reserve Bank would have no right to resort to the collateral until it had been adjudged negligent, and this could not be determined until a suit had been brought and decided or until all possible claims were barred by statute of limitation.

If the Federal Reserve Bank contemplates taking this collateral to be held as a trust for the benefit of member banks which deposit checks or for the benefit of the holders of such checks, it appears to me that the arrangement would be inconsistent with the limitations prescribed in the amendments to Regulation J.

Regulation J as amended reads in part as follows:

> "Neither the owner or holder of any such check, nor the bank which sent such check to the Federal Reserve Bank for collection 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."

Mr. George J. Seay, Governor. November 15, 1929.

M. G. Wallace, Counsel. Interpretation of Uniform Policy re Check Collections.

This language is very broad and appears to prohibit any or all agreements under which a forwarding bank or holder of a check can have any interest in or claim upon any collateral or property of the drawee bank in the possession of the Federal Reserve Bank.

If we should attempt to construe the positive provisions of the Regulation as meaning only that the forwarding bank or holder of a check should not have any claim upon any collateral unless such collateral were pledged under an agreement expressly providing for such claim, the provision of the Regulation would become ineffective for all purposes. In the so-called Lake City case it was assumed without discussion that the forwarding banks could have an interest in the reserve balance only in so far as such interest was created by the express terms of the circular. The Circuit Court of Appeals adopted this view and emphasized it by holding that the forwarding banks could have no interest in the surrender value of stock held by the drawee bank in the Federal Reserve Bank because the application of this surrender value was prescribed by law and could not be regulated by the provisions of a contract.

I do not see that there can be any distinction between the reservation of a lien upon certain designated collateral which is pledged to secure payment for checks and for no other purpose and the reservation of a lien upon collateral which is pledged to secure the payment of checks and likewise for other purposes, for it seems impossible to distinguish between the right to reserve two distinct liens upon two distinct funds and the right to reserve two liens, both of which shall attach to a single fund.

It therefore seems to me to be clear that if a Federal Reserve Bank may take collateral to secure the payment of cash letters in any case, the Federal Reserve Bank may take such collateral in every case, and if they may take collateral to secure the payment of cash letters and for no other purpose, they may take collateral which may be held for the payment of cash letters as well as for other purposes; and consequently it seems to me that the Regulation must be construed as prohibiting the taking of collateral to secure forwarding banks or the holders of checks in any case, or else it must be construed as having no substantial effect at all.

I recall, of course, that at the joint conference Governor Harding asked whether or not the action of his bank in taking collateral in a few special cases would be regarded as a violation of the general understanding that the policies of all Federal Reserve Banks should be uniform. I believe that I, as well as counsel for other banks present, stated that we certainly would not consider the action of the Federal Reserve Bank of Boston as being any violation of our private understanding, but for the reasons stated above I am forced to the conclusion that the proposal involves a technical violation of the Regulations.

Very truly yours,

M. G. Wallace,
Counsel.