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FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-6443

January 2, 1930.

SUBJECT: Liability Incurred by Member Bank in
Purchasing Federal Reserve Exchange.

Dear Sir:

In a ruling published in the Federal Reserve Bulletin for September, 1928, at page 656, the Federal Reserve Board held that the liability incurred by a member bank through the issuance of its cashier's check for Federal reserve exchange purchased, should be treated as a liability for money borrowed rather than as a deposit liability. The facts of the transaction which were under consideration by the Board at that time were described as follows:

A member bank which is temporarily short in its reserves arranges with another member bank having a temporary excess in reserves for the use of a stipulated amount of Federal reserve credit, for one day or more, as may be agreed upon. The bank purchasing the credit either gives its cashier's check to the selling bank, to be held for one day or more, as the case may be, or, dispensing with the formality of issuing a cashier's check, authorizes the selling bank to clear a ticket for the amount through the clearing house settlement on the day agreed upon, and the selling bank either gives its draft on the Federal reserve bank to the buying bank or arranges with the Federal reserve bank to transfer on the Federal reserve bank's books the stipulated amount from the account of the selling bank to the account of the buying bank.

It now appears that, while Federal reserve exchange is frequently purchased and sold in accordance with the method above described, this practice is not universally followed and it often happens that a member bank purchases Federal reserve funds from another member bank through the method of book entries, wire transfers or otherwise. The question has been presented to the Board as to how such transactions should be regarded in cases where the purchase and sale of Federal reserve exchange is accomplished by some method other than that described in its 1928 ruling.

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After considering this question the Board is of the opinion that all such transactions should be classified in accordance with the purpose to be effected and the principles involved rather than in accordance with the mechanics of their accomplishment. Transactions of this kind are manifestly temporary loans negotiated for the purpose of avoiding the necessity of rediscounting with the Federal reserve bank or showing a deficiency in reserves. The Board rules, therefore, that in every such transaction whether effected by check, book entries, wire transfers or otherwise, and regardless of the method of repayment, the purchasing member bank should show its resulting liability to the selling member bank as money borrowed and the selling member bank should treat the transaction as a loan made. In using the Board's Form 105 for report of condition, the purchasing member bank should show the liability incurred in any such transaction under "bills payable and rediscounts" and the selling member bank should enter the amount of the transaction under "loans and discounts".

Very truly yours,

R. A. Young,
Governor.

TO ALL GOVERNORS AND FEDERAL RESERVE
AGENTS.