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August 17., 1929.

To: The Federal Reserve Board.

From: Mr. Wyatt, General Counsel.

SUBJECT: 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.

The attached file pertains to the action taken by the Conference of Counsel of all Federal reserve banks and by the Governors' Conference on the above subject:

RECOMMENDATIONS.

After careful consideration of the recommendations of the Conference of Counsel and the action of the Governors' Conference, I respectfully recommend:

1. That the Board approve the uniform policy recommended by the Conference of Counsel and adopted by the Governors' Conference and request all Federal reserve banks to comply strictly with such uniform policy.

2. That the Board amend Paragraph 4 of Section V of Regulation J to read as follows:

> "(4) Checks received by a Federal reserve bank on its member or nonmember clearing banks will ordinarily be forwarded or presented direct to such banks and such banks will be required to remit or pay therefor at par in cash, by bank drafts acceptable to the collecting Federal reserve bank, by telegraphic transfers of bank credits acceptable to the collecting Federal reserve bank, or by authorizing the collecting Federal reserve bank to charge their reserve accounts or clearing accounts."

3. That the Board amend Paragraph (6) of Section V of Regulation J to read as follows:

> "(6) The amount of any check for which payment in actually and finally collected funds is not received shall be charged back to the forwarding bank, regardless of whether or not the check itself can be returned. In such event, 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."

A draft of a proposed circular letter to all Federal reserve banks announcing the action recommended above is respectfully submitted herewith.

DISCUSSION

Having been authorized to do so by the Board, I arranged for a conference of counsel of all Federal reserve banks to be held in Washington commencing on April 1 to consider the above subject. Simultaneously the Board placed the same subject on the program for consideration at the Governors' Conference, which was held in Washington at the same time. The object was to have the counsel for all of the Federal reserve banks endeavor to agree upon a uniform policy to be recommended to the Conference of Governors with a view of having such recommendations considered immediately by the Conference of Governors while counsel for the various Federal reserve banks were still in Washington and available for consultation either with their respective governors or with the Governors' Conference as a whole.

ACTION OF CONFERENCE OF COUNSEL.

The counsel of every Federal reserve bank was present at the conference and the first action of the Conference of Counsel was to adopt unanimously the following resolution:

> "RESOLVED, That it be the sense of this conference that uniformity among all of the Federal reserve banks in the treatment of reserve balances, collateral accounts and the cash surrender value of capital stock in relation to outstanding cash items, is desirable."

The Conference then proceeded to consider the question whether reserve balances of insolvent member banks, collateral pledged by them with the Federal reserve bank, and the proceeds of canceled Federal reserve bank stock should be utilized by them for the collection of checks which had been marked "paid" by the drawee banks and charged to the accounts of the drawers, but for which no remittance or remittances not finally collectible have been made, due to the insolvency of the drawee banks.

On this question a tentative vote showed that the Conference was divided eight to four and two committees were appointed to draft reports stating the majority and minority views. Subsequently, both committees submitted written reports, copies of which in their final form are attached hereto for the Board's information.

The majority report, which was adopted by the Conference of Counsel by a vote of eight to four and which was subsequently adopted by the Governors' Conference, was in the form of a resolution reading as follows:

> "WHEREAS there now exists a lack of uniformity among the twelve Federal reserve banks in their construction of Regulation J, as promulgated by the Federal Reserve Board,

which lack of uniformity has given rise to litigation in the past and holds promise of increased litigation in the future with conflicting decisions in various judicial districts; and

"WHEREAS, we deem it of the utmost importance that all of the Federal reserve banks follow a uniform policy in the respect stated:

"BE IT RESOLVED that the following represents the consensus of opinion of the Conference of Counsel to the various Federal reserve banks, assembled pursuant to the call of the General Counsel to the Federal Reserve Board:

"1. We construe Regulation J of the Federal Reserve Board as intended to provide that the Federal reserve banks shall take for collection checks sent to them for such purpose by other banks, merely as agents of the banks from which the same are received. We regard this policy as being economically sound, legally proper and fair in its operation.

"2. We believe that it would be extremely unwise to take any step or to formulate any policy which would tend to change this relationship and, specifically, that it would be unwise to attempt to superimpose upon a pure agency status any indicia of ownership with respect to the subject matter of the agency.

"3. We believe that it is incompatible with such agency status for Federal reserve banks to set-off amounts due to them, as agents for collection, against indebtedness due by them to insolvent member or non-member clearing banks; hence, we are of the opinion that after a bank has been closed the reserve bank of its district being notified of its suspension, should not thereafter attempt to charge unpaid cash items against the reserve account of the closed bank. For the same reason we believe that after notice of suspension a remittance draft, drawn by the closed bank, should not be charged against its reserve account.

"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.

"5. The status of the capital stock holdings of a member bank in its Federal reserve bank, upon the insolvency or liquidation of such member, is fixed by the Federal Reserve Act and, as we construe the same, the proceeds of such holdings could only be applied in or toward the satisfaction of debts due to the Federal reserve bank in its own right, as contradistinguished from debts which might be payable to the reserve bank as a collection agent.

"6. In our opinion, any deviation from these policies, in furtherance of which Regulation J was promulgated, would entail grave dangers to Federal reserve banks and would result in the preferring of a limited number of creditors of an insolvent bank, contrary to the letter and spirit of the law as it exists in the various States and as administered in the Courts of the United States.

"7. In view of the conflicting interpretations which have been placed upon Regulation J by the Federal reserve banks, resulting in conflicting judicial decisions in relation thereto, we deem it of the utmost importance that Regulation J be so clarified by amendment as to result in uniformity in its interpretation and application. Such amendment, we believe, should be made at the earliest possible time. To accomplish this purpose we recommend that subject to the approval of General Counsel to the Federal Reserve Board, paragraph 6 of Section V of Regulation J be amended to read substantially as follows:

> '(6) The amount of any check for which payment in actually and finally collected funds is not received shall be charged back to the forwarding bank, regardless of whether or not the check itself can be returned. The owner or holder of any such check so charged back shall, in such event, have no right of recourse upon, interest in or rights of payment from any fund, reserve, collateral or other property in the possession of the Federal reserve bank.'

We further recommend that subject to the approval of General Counsel to the Federal Reserve Board, paragraph 4 of Section V of Regulation J be amended to read substantially as follows:

> '(4) Checks received by a Federal reserve bank on its member or nonmember clearing banks will ordinarily be forwarded or presented direct to such banks and such banks will be required to remit or pay therefor at par, Such remittance or payment may be made in cash, by bank

draft acceptable to the collecting Federal reserve bank, by other funds or transfers acceptable to the collecting Federal reserve bank, or by authorizing the collecting Federal reserve bank to charge their reserve accounts or clearing accounts.'"

It will be seen that this resolution does two things: (1) It recommends a uniform policy to be followed by all Federal reserve banks and, (2) It recommends the adoption of two amendments to Regulation J, subject to my approval.

The proposed amendments to Regulation J were made subject to my approval because I had had no part in drafting them and it was thought possible that some changes in their phraseology might be found necessary. The understanding was that I was to be at liberty to recommend any changes in the phraseology which would not materially affect the substance of the proposed amendments without further consultation with the counsel of the various Federal reserve banks, but that, if I considered any very material changes in the substance of the proposed amendments to be necessary or advisable I would consult further with the counsel before recommending the adoption of such amendments to the Federal Reserve Board. The amendments which I have recommended above contain some slight changes in phraseology, but are substantially the same as those recommended by the majority of the Conference of Counsel and, therefore, I have not deemed it necessary to consult further with the counsel on this subject.

The minority report, which is too long to be quoted in this memorandum, but a copy of which is attached hereto for the Board's information, advocated the adoption of a policy opposite to that recommended by the majority and opposed the adoption of the proposed amendment to Paragraph (6) of Section V of Regulation J, but concurred in the recommendation of the majority with reference to the proposed amendment to Paragraph (4) of Section V of Regulation J.

In my opinion, the proposed uniform policy recommended by the majority of the Conference of Counsel is based upon a correct interpretation and application of, and is in every way consistent with, the provisions of Regulation J as promulgated by the Federal Reserve Board in 1924, which are still in effect and which have been sustained by the courts. In my opinion, the recommendation of the minority of the counsel is inconsistent with the fundamental principles of that Regulation. I am, therefore, of the opinion that the uniform policy recommended by the majority of the counsel should be approved by the Federal Reserve Board and that all Federal reserve banks should be requested to comply strictly therewith.

ACTION OF THE GOVERNORS' CONFERENCE.

When the Conference of Counsel was ready to report its recommendations, it met in joint session with the Conference of Governors; both the majority and minority reports were submitted to the Conference of Governors; the views of both the majority and the minority of the counsel were thoroughly explained, to the Conference of Governors and debated in the joint Conference of Governors and Counsel; and then the Governors went into executive session to consider both reports. After further consideration of both reports in executive session, the Conference of Governors adopted the following resolution:

> "RESOLVED, That we approve in substance the majority report of the Conference of Counsel, with the understanding that, to assist the Counsel of the Federal Reserve Board in framing the exact language of any amendments that may be found necessary to make the substance of the report effective, each Federal Reserve bank shall be at liberty to call his attention to any local arrangement that might be affected by any such amendments."

REPORTS FROM GOVERNORS OF THE VARIOUS BANKS.

Pursuant to the action of the Governors' Conference, the Governor of each Federal reserve bank was requested to advise the Board whether or not there were any local arrangements in his district which might be affected by the proposed amendments to Regulation J and which he might desire to have taken into consideration before those amendments were adopted by the Board.

Replies have now been received from the Governors of all Federal reserve banks and are attached hereto for the Board's information.

All of the Governors except those at the Federal Reserve Banks of New York and Philadelphia state that they know of no local arrangements which would be affected by the proposed amendments to Regulation J.

The Federal Reserve Bank of New York has no local arrangements which would be affected by the proposed amendments except the agreement under which it handles checks drawn on practically all member banks located in the boroughs of Manhattan, Bronx and Brooklyn which are not members of the New York clearing house. The agreements with these member banks provide that each morning each member shall send a representative to the Federal Reserve Bank to receive checks drawn on the member bank and the Federal Reserve Bank may charge to the member bank's reserve account the amount of checks delivered to such representative, subject to the right of the member bank to return any checks before 3 o'clock the same day and receive credit therefor.

With respect to certain large member banks, the reserve account would not be sufficient to cover such checks without credit for immediate credit items deposited by such member banks but which will not actually be collected until later in the day. The credit risk in such cases is probably insignificant; but, because of the large amounts sometimes involved, the Federal Reserve Bank considers it a serious question whether it should not take collateral to protect itself against possible loss from handling checks in this manner or to insure payment of such checks. The Federal Reserve Bank of New York has never taken such collateral but is considering the advisability of doing so.

The Federal Reserve Bank of Philadelphia uses two forms of collateral agreements to protect it in collecting checks: (1) A form of agreement intended to protect it against loss incurred by it in leaving collection items at nonmember city banks for examination and payment or return at a later hour during the day; and (2) A form of agreement intended to take care of the collection of items upon certain nonmember country banks where existing circumstances would make it unwise to collect such items without the protection afforded the Reserve Bank by the deposit of collateral.

The pledge of collateral with the Federal Reserve Bank to protect it against liability under the circumstances described by the Federal Reserve Banks of New York and Philadelphia might be considered inconsistent with the uniform policy recommended by the Conference of Counsel and approved by the Governors' Conference; but in my opinion it would not be a violation of the new language proposed to be added to the last paragraph of Section V of Regulation J.

The Federal Reserve Bank of Richmond calls attention to a local clearing house arrangement by which collateral is deposited by Richmond clearing house banks with a trust company to secure any member of the clearing house against loss as a result of checks being delivered through the clearing house for payment or return. The Federal Reserve Bank of Richmond does not consider this arrangement inconsistent with the proposed amendments and I concur in this view, since the securities are deposited with a trust company and not with a Federal reserve bank and are for the protection of all members of the clearing house and not for the protection of the Federal reserve bank alone.

The Federal Reserve Bank of Boston suggests that the new regulations be not drawn in such a way as to deny to any Federal reserve bank, either specifically or by implication, the right to protect itself against liability by making special arrangements to se-

cure the payment of checks in particular cases. I do not believe that the proposed amendments to the regulation could be construed as having this effect.

Although Governor Geery states that he knows of no local arrangements in the Minneapolis district which would be affected by the proposed amendments, Judge Ueland, Counsel for the Federal Reserve Bank of Minneapolis, in a personal letter to me, calls attention to two local arrangements which he thinks might be affected by the proposed amendments to Regulation J: (1) A collateral agreement used by the Federal Reserve Bank of Minneapolis, whereby all collateral pledged with the Federal reserve bank may be applied to any and all indebtedness due to the Federal reserve bank arising from any source whatsoever; and (2) An arrangement by which the Federal reserve bank acts as a clearing house for the Twin City Banks under the terms of which the Federal reserve bank is authorized at its option to charge to the reserve accounts of the respective banks the adverse balance of such bank's clearings on that day. Judge Ueland construes these arrangements as giving the owners of checks handled by the Federal reserve bank a right to insist that they be collected out of the reserve balance or the collateral pledged with the Federal reserve bank, and if they had this effect they would be inconsistent with the proposed amendments to the regulation. I do not, however, see how either one of these arrangements could have this effect; and, therefore, I do not consider that they would be affected by the proposed amendments. I assume that Governor Geery takes the same view and that this is the reason why he did not call these arrangements to the Board's attention.

I am of the opinion, therefore, that the replies received by the Federal Reserve Board from the various Federal reserve banks disclose no reason why the proposed amendments should not be adopted at this time.

IMPORTANCE OF A UNIFORM POLICY.

I heartily concur with the resolution adopted unanimously by all of the Counsel to the effect that uniformity among all of the Federal reserve banks in the treatment of reserve balances, collateral accounts and the cash surrender value of capital stock in relation to outstanding cash items is desirable.

The failure to have such a uniform policy has in the past resulted in the different Federal reserve banks working at cross purposes and endeavoring to establish in the courts conflicting principles governing the rights and liabilities of Federal reserve banks in this respect.

This will inevitably lead to confusion, uncertainty, and increased litigation between the Federal reserve banks, the receivers of insolvent member banks, and the endorsers or owners of checks sent to Federal reserve banks for collection but which were not collected because of the failure of the drawee banks. Such litigation is expensive, delays the final settlement of the affairs of insolvent member banks, and results in unfavorable criticism of the Federal reserve banks. A uniform policy strictly adhered to by all Federal reserve banks would remove much of this uncertainty, expedite final settlement of the affairs of insolvent member banks and will certainly result in more harmonious court decisions definitely fixing the rights and liabilities of the Federal reserve banks and removing the confusion and uncertainty which now exists.

It is impossible to obtain absolute unanimity of agreement as to what this uniform policy should be; but this is a case where, for the good of all concerned, it is better to let the majority rule and for the minority to yield their views in the interests of the general good. Much progress has been made in the formulation and recommendation of a uniform policy through the majority voteof the Conference of Counsel and the adoption of this policy by the Governors' Conference; and I believe that, in order to derive the maximum benefit from the action which has already been taken by the Governors' Conference, the Board should approve the uniform policy adopted by the Governors' Conference and request all of the Federal reserve banks to comply strictly with such policy. It is especially appropriate that the Board should do so in this case, because the policy really is an interpretation and application of the provisions of a regulation promulgated by the Federal Reserve Board.

In my opinion the uniform policy recommended by the Conference of Counsel and adopted by the Governors' Conference is in entire harmony with the purposes of Section V of Regulation J as promulgated by the Federal Reserve Board and contains a correct interpretation and application of that regulation. It is for this reason that I have recommended that the Board approve such policy.

PROPOSED AMENDMENTS TO REGULATION J.

The proposed amendment to Paragraph (4) of Section V of Regulation J is really in the nature of a clarifying amendment and was recommended unanimously by all of the counsel, since it was contained in both the majority and minority reports.

I have suggested two slight changes in the phraseology of the amendment recommended by the counsel: (1) in order to preserve the requirement that member banks and nonmember clearing banks not only remit at par for checks sent to them but also remit in one of the forms of remittance specified in the Regulation, I have made the entire paragraph a single sentence, instead of dividing it into two sentences as suggested by the counsel; and (2) I have suggested that the words "telegraphic transfers of bank credits" be substituted for the words "other funds or transfers", which appeared in the draft prepared by the Conference of Counsel, because I consider that language too broad and indefinite. I believe that the amendment as redrafted by me and as set forth on the first page of this memorandum would accomplish everything intended to be accomplished by the Conference of Counsel.

The proposed amendment to paragraph (6) of Section V of Regulation J recommended by the Conference of Counsel suggests no change in the existing language of that paragraph, but merely adds a new sentence, the purpose of which is to make clear that the owner or holder of a check charged back to the endorsing bank because payment in actually and finally collected funds was not received by the Federal reserve bank shall have no lien or right of recourse upon the reserve balance or capital stock investment of the drawee bank or any collateral pledged by the drawee bank with the Federal reserve bank or any other property of the drawee bank in the possession of the Federal reserve bank. It is not intended to prevent anyone having a claim against the Federal reserve bank from enforcing their rights against the Federal reserve bank. Nor would it prevent the Federal reserve bank from offsetting the amount of any check owned by the Federal reserve bank, or of which the Federal reserve bank had virtually become the owner through having become liable for the amount therof as a result of negligence on its part against the reserve balance of the drawee bank, the collateral pledged with the Federal reserve bank by the drawee bank, or the capital stock investment of the drawee bank.

It is believed that this amendment will prevent the tying up of funds or property of member banks in the hands of the Federal reserve bank pending litigation to determine the rights of the respective parties and will thus expedite the final settlement of the affairs of insolvent member banks. By clearly defining the rights and liability of all persons having an interest in checks collected through

the Federal reserve banks it should also lessen the chances of litigation. This is in accordance with the fundamental purpose of the whole of Section V of Regulation J, which really specifies the terms of a contract to be entered into between the Federal reserve bank and all banks for which it undertakes to collect checks and clearly defines the respective rights and liabilities of both parties to such contract.

In the form of amendment recommended on the first page of this memorandum, I have endeavored to clarify the language of the new sentence which the Conference of Counsel recommended to be added to this paragraph. As recommended by the Conference of Counsel, this new language applies only to the "owner or holder" of any check so charged back and thus might be held not to apply to the bank which sent the check to the Federal reserve bank for collection and which, under the terms of Paragraph (1) of Section V of Regulation J, is the only party having any privity contract with the Federal reserve bank. I have, therefore, changed the first part of the sentence to read, "In such event, 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", etc. I have also inserted the words " of the drawee bank" immediately after the word "property", in order to make it clear that the purpose of this amendment is not to protect the property of the Federal reserve bank from levy or execution where the Federal reserve bank is held liable for negligence. In other words, I wish to make it clear that the amendment applies only to property of the drawee bank in the hands of the Federal reserve bank and does not apply to the property of the Federal reserve bank itself.

The changes of phraseology which I have recommended do not make any material change in the substance of the amendment recommended by the Conference of Counsel and I am sure that they are entirely in harmony with the purpose of the amendment recommended by the Conference of Counsel.

OTHER POSSIBLE AMENDMENTS

There are certain other amendments to Regulation J which I think might profitably be adopted at an appropriate time; and I have given very serious consideration to the question whether such other amendments ought to be adopted at this time. Such other amendments, however, could not very well be adopted without first consulting all of the Federal reserve banks and this would result in much additional delay and probably in further differences of opinion. In view of the fact that a uniform policy has already been agreed upon by the Governors' Conference and certain amendments have been recommended

by the Governors' Conference, therefore, I believe it would be better to adopt at this time the amendments which have been recommended and to leave the question of any further amendments for consideration when the Board next undertakes a general revision of all its Regulations.

CONCLUSION

I, therefore, believe that the best disposition of this matter at the present time would be for the Board to adopt the recommendations which I have made on the first page of this memorandum and send out the attached letter to all Federal reserve banks.

Respectfully,

Walter Wyatt,
General Counsel.

Papers Attached.

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REPORT OF MINORITY COMMITTEE

We, the undersigned, representing the Federal Reserve Banks of Chicago, Minneapolis, Philadelphia and Richmond, are unable to concur in the recommendation of the majority of the Conference of Counsel and in lieu of the amendment recommended by the majority we recommend that paragraph 4 of Section V of Regulation J be amended to read as follows:

> "(4) Checks received by a Federal reserve bank on its member or nonmember clearing banks will ordinarily be forwarded or presented direct to such banks and such banks will be required to remit or pay therefor at par. Such remittance or payment may be made in cash, by bank draft acceptable to the collecting Federal reserve bank, by other funds or transfers acceptable to the collecting Federal reserve bank, or by authorizing the collecting Federal reserve bank to charge their reserve accounts or clearing accounts."

The object of this amendment is merely to clarify the meaning of the existing paragraph.

We recommend that paragraph 6 of Section V of Regulation J be amended so as to have it read as follows:

> "(6) The amount of any check for which payment in actually and finally collected funds is not received may be charged back to the forwarding bank regardless of whether or not the check itself can be returned, but the Federal reserve bank may charge the amount of any check not returned unpaid to the reserve account or clearing account, as the case may be, of the bank from which such payment was not received, and may hold any other property of such bank in its possession as security for payment of such check. The right so to do shall, however, be subordinate and without prejudice to all other rights of the Federal reserve bank upon such reserve account and clearing account and to such other property in its possession."

Our reasons for recommending the amendment last mentioned are as follows:

The Federal Reserve Board in promulgating Regulation J has stated that it desires to afford to the public and to the various banks of the country a direct, expeditious, and economical system of check collection

and settlement of balances and for that purpose has arranged to have each Federal reserve bank exercise the function of a clearing house and collect checks for such of its member and non-member clearing banks as desire to avail themselves of the privilege and the Board further required in its Regulation that each Federal reserve bank shall exercise the function of a clearing house and collect checks under the general terms and conditions thereinafter set forth and that each member bank and non-member clearing bank shall cooperate fully in the system of check clearance and collection for which provision is made in the Regulations. When the Federal reserve banks were made clearing houses for their member banks we think it was not contemplated that the banks on which checks were drawn should be at liberty to convert the checks and place the owners of checks presented through the clearing system in the position of creditors of an insolvent bank. This amendment is suggested from the point of view that the Federal Reserve Board should make provision for holding each member of the clearing house as far as possible to its obligation to the other members of the clearing house.

Whenever a check is cancelled by the drawee bank and charged to the account of the drawer, the drawer is by the great weight of authority released from liability to the holder and the holder is required to look to the drawee bank. The holder seldom knows or has opportunity to investigate the condition of the bank upon which a check held by him is drawn. Hence, when he is forced to release the drawer, his original debtor, and to assume the position of a creditor of the drawee bank and sustains any loss because such bank fails to remit or pay for a check which has been cancelled so that he can neither obtain the return of the check nor collect the amount of it, the holder feels that he has a just cause of dissatisfac-

tion with the System which has placed him in this position.

Since the check collection system was, as we have pointed out above, established primarily for the safety, convenience, and benefit of the business public, it is highly desirable to avoid losses to the public from such a situation whenever it is possible to do so and such losses can be avoided in most cases if the Federal reserve bank has the right to resort to the reserve balance of a failed member bank and to the proceeds of existing collateral to protect the holders of checks deposited for collection after the prior demands of the Federal reserve banks are satisfied.

We consider that the primary purpose of the reserve balance is to enable the member banks to meet withdrawals and the principal way in which withdrawals are made is by checks drawn on the member bank, most of which are presented through the Federal reserve banks. Hence, the reserve deposit of a member bank in the hands of a Federal reserve bank may appropriately and consistently within the spirit of the Federal Reserve Act be made applicable to the payment of checks presented through the Federal reserve banks rather than held as a protection for the general creditors of the member bank.

We are informed that commercial banks in the past, while limiting their liability for failure to collect checks deposited with them, have, nevertheless, used any funds or property in their possession belonging to the drawee bank for the benefit of endorsers. Practically all judicial decisions that have come to our attention are in accord in sustaining the right of the forwarding bank to do this and we believe that Federal reserve banks should adopt the position so sanctioned by the prior usage of commercial banks in collecting checks and afford to the depositors complete protection against the default of the drawee bank when it is practicable to

do so.

We do not think that this plan, which we recommend, gives any undue preference to persons collecting checks through Federal reserve banks, for such persons only obtain payment on checks on which the drawers are released and which are, therefore, deemed paid so far as the drawers, who are the depositors of the failed bank, are concerned.

Federal reserve banks are frequently under compulsion to forward items direct to a member bank known to be in an extended condition. To send a messenger to collect in cash in such a case would often result in the suspension of the drawee bank, owing to a mere temporary shortage of available funds. Yet any other method of collection in such a case might constitute negligence and create liability on the part of the Federal reserve bank to depositors of checks. The policy we suggest has the advantage of reducing such liability, which we believe is unavoidable in many cases, to a minimum.

For the Federal Reserve Bank of Chicago.

For the Federal Reserve Bank of Minneapolis.

For the Federal Reserve Bank of Philadelphia.

For the Federal Reserve Bank of Richmond.