

June 27, 1930.

Federal Reserve Board
Mr. Wyatt - General Counsel.

Amendments to Regulation J
Recommended by the Conference of
Counsel.

On June 17th I submitted to the Board for its information a copy of the Minutes of the Conference of Counsel of all Federal reserve banks held in Washington on June 9th and 10th, which recommended that the Board adopt certain amendments to Regulation J for the purpose of clarifying the rights, duties and responsibilities of all parties to the collection of checks through Federal reserve banks and for the purpose of protecting Federal reserve banks against unwarranted liabilities which might otherwise result from the recent decision of the Supreme Court of the United States in the case of Thomas A. Early, Receiver, v. Federal Reserve Bank of Richmond.

I now respectfully submit herewith a letter addressed to the Board by Honorable Newton D. Baker recommending that the Board adopt these proposed amendments to Regulation J, with certain slight changes in punctuation and phraseology, at the earliest possible date.

RECOMMENDATIONS

I respectfully recommend:

1. That the attached amendments to Regulation J, as recommended by the Conference of Counsel, with certain changes in phraseology and punctuation suggested by Honorable Newton D. Baker and myself, be adopted by the Board at the earliest possible date and be made effective thirty days after their adoption;
2. That, if the Board is unwilling to adopt these amendments without further consultation with the Federal reserve banks, the attached draft of the amendments with the changes in phraseology recommended by Mr. Baker and myself, be transmitted to all Federal reserve banks immediately with a request that they advise the Board of their views thereon at the earliest possible moment;
3. That, if the replies received from the Federal reserve banks disclose no important differences of opinion, the Board immediately adopt the proposed amendments without awaiting the action of a Conference of Governors on this subject; and
4. That the Board immediately request Governor Calkins to request the Standing Committee on Collections, with the assistance of the undersigned and a committee of Counsel of the Federal reserve banks, to proceed immediately to prepare a revision of the uniform provisions of the check collection circulars of the Federal reserve banks, in order that the new check collection circulars may be adopted, printed and distributed within thirty days after the Board adopts the proposed amendments to Regulation J.

With all of the Federal reserve banks represented by one or more Counsel and with four members of the Standing Committee on Collections present and participating in the discussion, the Conference recommended these amendments to Regulation J with only one dissenting vote, that of Mr. M. G. Wallace, Counsel to the Federal Reserve Bank of Richmond, who explained that he was acting in accordance with definite instructions from the officers of his bank. However, several of the counsel requested that they be placed on record as opposing in principle certain of the amendments, although they voted for the recommendation as a whole for the sake of uniformity. These statements, which were dictated to a stenographer during the meeting and carefully checked by the persons making them, were incorporated in the Minutes of the Conference, a copy of which is attached hereto for the Board's information.

The Conference voted to recommend the proposed amendments to Regulation J in the form set forth in the attached copy of the Minutes of the Conference, with the understanding that Honorable Newton D. Baker and the undersigned should be at liberty to make such changes in the punctuation and phraseology of the amendments as might be deemed advisable but without making any changes in the substance of the amendments.

It will also be necessary for the check collection circulars of the Federal reserve banks to be revised so as to conform to the amended regulation; and the Conference adopted a resolution requesting the Chairman of the Governors' Conference to instruct the Standing Committee on Collections to prepare a revised draft of the uniform provisions of the check collection circulars with the assistance of a committee consisting of the undersigned and Counsel for several of the Federal reserve banks as soon as possible.

Honorable Newton D. Baker, who had been retained by the Board for the purpose of giving the Board the benefit of his views as to any amendments to Regulation J which might be recommended by the Conference of Counsel, was unable to reach Washington until after the Conference was over; but, prior to the Conference, he studied all letters and memoranda which had been written on this subject and was fully acquainted with the problems before the Conference and with the views with respect to these problems which had been expressed by this office and by Counsel to the various Federal reserve banks. On Wednesday, June 11, Mr. Baker and I, together with Counsel for a number of the Federal reserve banks, carefully examined the proposed amendments to Regulation J recommended by the Conference and agreed upon certain changes in the phraseology of the amendments which would clarify and improve the form of the amendments, but would make no changes in the substance thereof.

VIEWS OF MR. BAKER AND MR. WYATT.

After consultation and after very careful consideration of the proposed amendments to Regulation J recommended by the Conference of Counsel, Mr. Baker and I are of the opinion that these proposed amendments (with our

suggested changes in phrasology) are entirely consistent with the method of collecting checks heretofore authorized by the Board in its Regulation J; that they more clearly define the rights, duties and responsibilities of all parties to the collection of checks through the Federal reserve banks than the existing regulations; that they are a distinct improvement over the existing regulations; that the regulation as so amended would afford to the Federal reserve banks much greater protection against unwarranted liabilities resulting from the recent decision of the Supreme Court in the Early Case; and that they would greatly reduce the chances of litigation which otherwise might result from the decision of the Supreme Court in the Early Case.

Mr. Baker and I, therefore, are of the opinion that it is very important to the Federal Reserve System that Regulation J and the check collection circulars of the Federal reserve banks be amended at the earliest possible date in accordance with the recommendations made by the Conference of Counsel but with the changes in phraseology which we have agreed upon.

TEXT OF PROPOSED AMENDMENTS.

The proposed amendments to Regulation J in the form recommended by the Conference of Counsel are set forth in the Minutes of the Conference of Counsel, a copy of which is attached hereto. With the slight changes in phraseology suggested by Mr. Baker and myself, which did not change the substance of the proposed amendments and are in no way inconsistent with the amendments recommended by the Conference of Counsel, these proposed amendments are as follows:

"SECTION III

"That paragraph 1 of Section III be amended by changing the words "acceptable to the Federal Reserve Bank of the District in which such nonmember banks are located" to read 'acceptable to the collecting Federal reserve bank.'

"That paragraph 3 of Section III be amended by changing the words 'acceptable to the Federal Reserve Bank of the District in which such nonmember bank is located' to read 'acceptable to the collecting Federal reserve bank'.

"SECTION IV.

"That paragraph 2 of Section IV be amended by changing the period at the end thereof to a comma and by adding the following words:

"'provided, however, that the Federal reserve bank may in its discretion refuse at any time to permit the withdrawal or other use of credit given for any item for which the Federal reserve bank has not yet received payment in

"actually and finally collected funds."

"That paragraph 3 of Section IV be amended by changing the period at the end thereof to a comma and by adding the following words:

"provided, however, that the Federal reserve bank may in its discretion refuse at any time to permit the withdrawal or other use of credit given for any item for which the Federal reserve bank has not yet received payment in actually and finally collected funds."

"SECTION V.

"That Section V be amended to read as follows:

"SECTION V. TERMS OF COLLECTION.

"The Federal Reserve Board hereby authorizes the Federal reserve banks to handle such checks subject to the following terms and conditions; and each member and nonmember clearing bank which sends checks to any Federal reserve bank for deposit or collection shall by such action be deemed (a) to authorize the Federal reserve banks to handle such checks subject to the following terms and conditions, (b) to warrant its own authority to give the Federal reserve banks such authority, and (c) to agree to indemnify any Federal reserve bank for any loss resulting from the failure of such sending bank to have such authority.

"(1) A Federal reserve bank will act only as agent of the bank from which it receives such checks and will assume no liability except for its own negligence and its guaranty of prior indorsements.

"(2) A Federal reserve bank may present such checks for payment or send such checks for collection direct to the bank on which they are drawn or at which they are payable, or in its discretion may forward them to another agent with authority to present them for payment or send them for collection direct to the bank on which they are drawn or at which they are payable.

"(3) A Federal reserve bank may, in its discretion and at its option, either directly or through or from an agent, accept in payment of or in remittance for such checks, cash, bank drafts, transfers of funds or bank credits, or other forms of payment or remittance, acceptable to the collecting Federal

reserve bank. The Federal reserve bank shall not be liable for the failure of the drawee bank or any agent to pay or remit for such checks, nor for any loss resulting from the acceptance from the drawee bank or any collecting agent, in lieu of cash, of any other form of payment or remittance authorized herein, nor for the nonpayment of, or failure to realize upon, any bank draft or other medium of payment or remittance which may be accepted from the drawee bank or any collecting agent.

"(4) Checks received by a Federal reserve bank which are payable in its own district will ordinarily be forwarded or presented direct to the banks on which they are drawn, and such banks will be required to remit or pay therefor at par in such one or more of the forms of payment or remittance authorized under paragraph (3) hereof as may be acceptable to the Federal reserve bank.

"(5) Checks received by a Federal reserve bank payable in other districts will ordinarily be forwarded for collection to the Federal reserve bank of the district in which such checks are payable; provided, however, that, where arrangements can be made satisfactory to the collecting bank or agent and to the Federal reserve bank of the district in which such checks are payable, any such checks may be forwarded for collection direct to the bank on which they are drawn or at which they are payable, or may be forwarded for collection to another agent with authority to present them for payment direct to the bank on which they are drawn or at which they are payable. All such checks shall be handled subject to all the terms and conditions of this Regulation.

"(6) Bank drafts received by a Federal reserve bank in payment of or in remittance for checks handled under the terms of this regulation shall likewise be handled for collection subject to all the terms and conditions of this regulation.

"(7) 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 reserve balance, clearing account,

deposit account, or other such fund of the drawee bank or of any bank to which such checks have been sent for collection, in the possession of the Federal reserve bank. No draft, authorization to charge, or other order, upon any reserve balance, clearing account, deposit account, or other such funds of a paying, remitting, or collecting bank in the possession of a Federal reserve bank, issued for the purpose of settling items handled under the terms of this Regulation will be paid, acted upon, or honored after receipt by such Federal reserve bank of notice of suspension or closing of such paying, remitting, or collecting bank."

There is also submitted as a separate document a print showing the exact textual changes which would be made in the regulation by the proposed amendments and also the changes in phraseology made by Mr. Baker and the undersigned.

EXPLANATION OF PROPOSED AMENDMENTS.

Sec. III. The proposed amendments to paragraphs 1 and 3 of Section III make no important changes in the regulation, but merely change the phraseology thereof so as to conform to another proposed amendment designed to permit Federal reserve banks to send checks for collection direct to banks in another district, in accordance with recommendations of the Governors' Conference and the Standing Committee on Collections which will hereafter be explained.

Sec. IV. The proposed amendments to paragraphs 2 and 3 of Section IV were suggested by Mr. Walter S. Logan, Counsel to the Federal Reserve Bank of New York, and are designed to make clear the right of a Federal reserve bank to refuse to permit the withdrawal or other use of credit given for any item for which a Federal reserve bank has not received payment in actually and finally collected funds.

Under the terms of Section IV of Regulation J, immediate credit is given for certain checks and credit is given for all other checks at the expiration of the time stated in the time schedule, regardless of whether or not the checks have actually been collected. Under the terms of the regulation the credit thus given is subject to final payment, and the Federal reserve bank clearly has the right to charge the checks back to the member bank if final payment is not received. If the member bank draws out its reserve balance and fails before final payment is received on such checks, however, the Federal reserve bank probably would be unable to collect the checks and there would be no reserve balance to which they could be charged. In the case of banks in an extended condition, therefore, it is important that the Federal reserve bank have the right to refuse to permit the withdrawal of credit given for checks which have not finally been collected; and, in order to prevent "kiting", it may be important for the Federal reserve banks to have this right as to perfectly solvent member banks.

I understand that the Federal reserve banks have assumed that they have this right and have exercised it whenever the occasion seemed to warrant it; but the view was expressed that their right to refuse to permit member banks to draw against uncollected funds might sometimes be challenged, in view of the present language of the regulations to the effect that credit given in the reserve account, subject to final payment, will be "counted as reserve and become available for withdrawal or other use by the sending bank." I understand that, if this amendment is adopted, the Federal reserve banks do not intend to make any change in their present practice; but they desire this amendment in order that there may be no doubt of their right to continue their present practice.

The practice of reserving the right to refuse to honor checks drawn against uncollected funds is in accordance with commercial banking practice, and I know of no reason why the Federal reserve banks should not reserve such right.

Section V of Regulation J, which deals with "Terms of Collection", consists of an introductory paragraph which is not numbered and six paragraphs numbered from 1 to 6 inclusive. The Conference recommended no changes whatever in the introductory paragraph and in paragraphs numbered 1 and 2. These paragraphs, as set forth in the attached resolution, therefore, are exactly the same as the corresponding paragraphs of the existing regulation.

Paragraph 3 - The Conference recommended that paragraph 3 of Section V of Regulation J be amended as follows, the letters in ordinary type indicating the present language of the regulation, the canceled words being stricken from the present regulation, and the words in capital letters being inserted:

"(3) A Federal reserve bank may, in its discretion and at its option, either directly or through OR FROM an agent, accept either cash ~~or bank drafts~~ in payment of or in remittance for such checks, CASH, BANK DRAFTS, TRANSFERS OF FUNDS OR BANK CREDITS, OR OTHER FORMS OF PAYMENT OR REMITTANCE, ACCEPTABLE TO THE COLLECTING FEDERAL RESERVE BANK. THE FEDERAL RESERVE BANK shall not be held liable FOR THE FAILURE OF THE DRAWEE BANK OR ANY AGENT TO PAY OR REMIT FOR SUCH CHECKS, NOR for any loss resulting from the acceptance of ~~bank drafts FROM THE DRAWEE BANK OR ANY COLLECTING AGENT~~, in lieu of cash, OF ANY OTHER FORM OF PAYMENT OR REMITTANCE AUTHORIZED HEREIN, ~~nor for the failure of the drawee bank or any agent to remit for such checks~~, nor for the nonpayment of, OR FAILURE TO REALIZE UPON any bank draft accepted in payment ~~or as a~~ OR OTHER MEDIUM OF PAYMENT OR remittance WHICH MAY BE ACCEPTED FROM the drawee bank or any COLLECTING agent."

The principal changes proposed to be made in the substance of this paragraph are as follows:

Whereas paragraph 3 of the present regulation in terms authorizes the Federal reserve bank to accept only cash or bank drafts in remittance for checks forwarded for collection, it is proposed to have the new regulation authorize the acceptance of such other forms of payment or remittance as are customarily accepted by Federal reserve banks, and very broad language is used for this purpose. It is not contemplated that this amendment will result in any change in the present practices of the Federal reserve banks, but it is intended clearly to authorize the continuation of the present practices. In addition to cash and bank drafts, the Federal reserve banks accept informal authorizations to charge the amount of such checks to the reserve account of the drawee bank, telegraphic transfers of bank funds and in some instances an authorization to charge the amount of such checks to the reserve account of a bank other than the drawee bank. The purpose of the amendment, therefore, is simply to broaden the language so as to cover all forms of remittance customarily accepted by the Federal reserve banks. While the language might seem quite broad, I see no objection to it, because the Federal reserve banks, for their own protection, would insist upon the best form of remittance that they can possibly get.

Par. 4. The proposed changes in paragraph 4 are as follows:

"(5) Checks received by a Federal reserve bank on its member or nonmember clearing banks WHICH ARE PAYABLE IN ITS OWN DISTRICT will ordinarily be forwarded or presented direct to such THE banks, - ON WHICH THEY ARE DRAWN, and such banks will be required to remit or pay therefor at par in cash or bank draft SUCH ONE OR MORE OF THE FORMS OF PAYMENT OR REMITTANCE AUTHORIZED UNDER PARAGRAPH(3) HEREOF AS MAY BE acceptable to the collecting Federal reserve bank, or at the option of such Federal reserve bank to authorize such Federal reserve bank to charge their reserve accounts or clearing accounts.

The principal change in paragraph 4 is the elimination therefrom of the specific mention of the form of payment of remittance which will be expected from the drawee bank and the substitution therefor of a general statement to the effect that the drawee banks will be required to pay for such checks at par "in such one or more of the forms of payment or remittance authorized under paragraph 3 hereof as may be acceptable to the Federal reserve bank." Having specified in paragraph 3 all of the forms of remittance customarily received by Federal reserve banks, it was deemed unnecessary to repeat the specific mention of these various forms of remittance in paragraph 4, and it was thought better merely to refer to paragraph 3.

There is one other change proposed to be made in paragraph 4 which I think I should call specially to the Board's attention. In the existing regulation, this paragraph is limited to checks received by the Federal reserve bank on its member or nonmember clearing banks, and the paragraph contains a requirement that such banks remit at par for the checks sent to them. Because this paragraph also states the forms of remittance which will be expected by the Federal reserve banks from all banks to which such checks are sent for collection, including par remitting nonmember banks which maintain no clearing account, the Conference felt that it should not be limited to member banks and nonmember clearing banks. Heretofore it has been limited to member banks and nonmember clearing banks; because it contains a requirement that such banks remit at par, and the Federal Reserve Board has no right to require nonmember banks to remit at par. In practice, however, the only checks which are forwarded direct to nonmember banks are checks on those which voluntarily agree to remit at par; and therefore, it would seem appropriate for this paragraph to apply to nonmember banks as well as to member banks and nonmember clearing banks.

By making the paragraph containing a requirement that they remit at par apply to nonmember banks, it might be contended that the Federal Reserve Board is again attempting to enforce par clearance on nonmember banks which are unwilling to remit at par; but this contention would be absurd in view of the provisions of Section III of Regulation J, which clearly forbid the Federal reserve banks to receive on deposit or for collection any check on any nonmember bank which cannot be collected at par. The classes of checks which can be received for collection are specified by Section III of the Regulation; and Section V deals only with the terms governing the collection of such checks.

I therefore, feel that there is no objection to the proposed amendment to paragraph 4.

Paragraph 5. The proposed change in paragraph 5 recommended is as follows:

"(5) Checks received by a Federal reserve bank payable in other districts will ORDINARILY be forwarded for collection ~~upon the terms and conditions herein provided to the Federal reserve bank of the district in which such checks are payable;~~ PROVIDED, HOWEVER, THAT WHERE ARRANGEMENTS CAN BE MADE SATISFACTORY TO THE COLLECTING BANK OR AGENT AND TO THE FEDERAL RESERVE BANK OF THE DISTRICT IN WHICH SUCH CHECKS ARE PAYABLE, ANY SUCH CHECKS MAY BE FORWARDED FOR COLLECTION DIRECT TO THE BANK ON WHICH THEY ARE DRAWN OR AT WHICH THEY ARE PAYABLE, OR MAY BE FORWARDED FOR COLLECTION TO ANOTHER AGENT WITH AUTHORITY TO PRESENT THEM FOR PAYMENT DIRECT TO THE BANK ON WHICH THEY ARE DRAWN OR AT WHICH THEY ARE PAYABLE. ALL SUCH CHECKS SHALL BE HANDLED SUBJECT TO ALL THE TERMS AND CONDITIONS OF THIS REGULATION."

The only purpose of the proposed changes in this paragraph is to enable the Federal reserve banks to forward checks for collection direct to drawee banks in other districts, in order to expedite the collection of such checks when satisfactory arrangements can be made with the Federal reserve bank of the district in which such checks are payable and with the drawee banks or with the banks to which such checks are forwarded for collection.

It will be remembered that the Standing Committee on Collections had recommended to the Governors' Conference that Federal reserve banks be authorized at their discretion to conduct an experiment along this line by sending checks for collection direct to drawee banks located in the principal cities in States adjoining their districts, when appropriate arrangements could be made with the drawee banks and Federal reserve banks of the other district, provided that I was of the opinion that such practice would be legal. I advised the Board that such practice would not violate the law, provided that no checks received from other Federal reserve banks were handled in this way, but that Regulation J prohibits such practice, because it requires all Federal reserve banks receiving checks payable in other districts to forward them to the Federal reserve banks of the district in which they are payable. The Board advised the Federal reserve banks of my opinion in a letter addressed to them under date of October 31, 1929 (X-6405); and the Governors' Conference requested the Standing Committee on Collections to prepare a proposed amendment to Regulation J for this purpose.

The above quoted amendment is substantially the same as the one drafted by the Standing Committee on Collections, pursuant to this request of the Governors' Conference; and I know of no reason why it should not be adopted.

Paragraph 6. The proposed paragraph 6 is entirely new and is intended to enable the Federal reserve banks to handle the bank drafts which they receive in remittance for checks handled under the terms of Regulation J without having to present such bank drafts over the counter and insist upon payment in cash in accordance with the old common law rules. In my opinion, this is entirely consistent with the other provisions of Regulation J and is justified by the fact that it is practically impossible for Federal reserve banks always to obtain remittances in the form of cash or drafts on the reserve account and, therefore, they must frequently accept bank drafts drawn on other banks. Wherever possible, they insist upon drafts drawn upon other banks located in the city of the collecting Federal reserve bank, so that they can be collected on the day on which they are received; but, even in such cases, such drafts usually are not presented across the counter and collected in cash, but are collected through the local clearing houses or through some clearing house arrangement entered into by the Federal reserve bank with the banks located in the Federal reserve city. It is not always possible to obtain drafts drawn on banks located in the city of the collecting Federal reserve banks; and, when drafts are received on banks outside of such cities, it is necessary for the Federal reserve bank to forward them through the mails for collection. In all such instances it is vitally important that the Federal reserve banks have the right to

handle such bank drafts exactly in the same way that they handle other checks for collection. I, therefore, proposed this amendment myself and have no doubt that its adoption is thoroughly justified.

Paragraph 7. The proposed amendment to paragraph 7 is as follows:

"(7) 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 RESERVE BALANCE, CLEARING ACCOUNT, OR DEPOSIT ACCOUNT, OR OTHER SUCH FUND OF THE DRAWEE BANK OR OF ANY BANK TO WHICH SUCH CHECKS HAVE BEEN SENT FOR COLLECTION, IN THE POSSESSION OF THE FEDERAL RESERVE BANK. NO DRAFT, AUTHORIZATION TO CHARGE, OR OTHER ORDER UPON ANY RESERVE BALANCE, CLEARING ACCOUNT, DEPOSIT ACCOUNT, OR OTHER SUCH FUNDS OF A PAYING, REMITTING, OR COLLECTING BANK IN THE POSSESSION OF A FEDERAL RESERVE BANK, ISSUED FOR THE PURPOSE OF SETTLING ITEMS HANDLED UNDER THE TERMS OF THIS REGULATION WILL BE PAID, ACTED UPON, OR HONORED AFTER SUCH FEDERAL RESERVE BANK OF NOTICE OF SUSPENSION OR CLOSING OF SUCH PAYING, REMITTING, OR COLLECTING BANK."

This is the most important amendment recommended by the Conference of Counsel, and is intended to clarify the rights, duties and responsibilities of all parties to the collection of the checks through Federal reserve banks and to protect the Federal reserve banks against the assumption of unwarranted liabilities as a result of the decision of the Supreme Court of the United States in the Early Case.

The first sentence of this paragraph is the same as paragraph 6 of the present regulation. It has been in the regulation ever since 1924, and no change is proposed to be made in it.

The second sentence of this paragraph is similar to the proposed amendment recommended by the Conference of Counsel in April, 1929, but omits the reference to collateral and other property of the drawee bank in the possession of the Federal reserve bank which gave rise to the difference of opinion amongst the eight counsel voting for that recommendation last year and gave rise to the question raised by Governor Harding in his letter of October 19, 1929. In other words, it is now proposed that this sentence refer only to any reserve balance, clearing account, deposit account or other such fund of the drawee bank, or of any bank to which such checks have been sent for collection, and that it makes no reference to collateral or other property of such other banks in the possession of the Federal reserve bank. Whereas, last year the corresponding amendment to Regulation J was voted for by only 8 of the 12 counsel and they were divided on its interpretation by a vote of 5 to 3; this year the representatives for all of the Federal reserve banks

except Richmond voted for it in this modified form.

This sentence is also modified so as to conform to the suggestion made by Deputy Governor Blair of the Federal Reserve Bank of Chicago in his letter of October 22, 1929, - i.e., so as to apply to drafts or other orders upon the reserve accounts of banks to which checks are sent for collection as well as to drafts or orders upon the reserve account of the drawee bank. I originally opposed this suggestion; but, upon further reflection, I believe it is wise to adopt it.

The last sentence of this paragraph, which is entirely new, was proposed originally by Mr. Agnew, Counsel to the Federal Reserve Bank of San Francisco, and is intended definitely to prohibit the practice engaged in by the Federal Reserve Bank of Richmond, which gave rise to the Early Case and resulted in a decision extremely dangerous to all of the Federal reserve banks. The proposed amendment is in accordance with the generally accepted view that, upon the appointment of a receiver for a bank, the rights of all parties become fixed and no action can be taken thereafter changing or affecting the rights of any parties having dealings with the insolvent bank. This view is very strongly maintained by the Office of the Comptroller of the Currency, and a failure to accept it must necessarily result in further litigation. Regardless of whether such drafts or orders may lawfully be charged to the reserve account of a member bank after the appointment of a receiver for such bank, it is my opinion, and obviously was the opinion of the majority of the counsel, that the Federal reserve banks have a right by contract to stipulate that no such draft, authorization to charge, or other order will be executed or charged to the reserve account after receipt of notice of suspension or closing of the bank issuing such order and that, where this is clearly understood in advance, no injustice results.

Section V of Regulation J defines the terms upon which Federal reserve banks will collect checks, and all banks which send checks to Federal reserve banks for collection agree to these terms. In my opinion, it is perfectly competent and entirely proper for them to agree that no draft, authorization to charge or other order upon funds of a paying, remitting or collecting bank in the possession of a Federal reserve bank, issued for the purpose of settling items handled under the terms of this regulation, will be paid, acted upon or honored after receipt by such Federal reserve bank of notice of suspension or closing of such paying, remitting or collecting bank; and I believe that it is important to include this provision in the regulation, so that there will be a clear understanding on this point and litigation which otherwise would arise will be avoided.

INTERPRETATION OF UNIFORM POLICY.

The Conference discussed the advisability of adopting some further resolution regarding the interpretation of the uniform policy recommended by the Conference of Counsel and adopted by the Conference of

Governors in April, 1929, but took no formal action thereon, because it believed that the uniform policy previously adopted, together with the vote taken by the Governors' Conference at its meeting in December, 1929, completely covered the subject, especially since it is now proposed to eliminate from the amended regulations all reference to collateral.

It will be remembered that the uniform policy contained the following paragraph pertaining to collateral:

"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."

The amendment then proposed to paragraph 6 of the Regulation provided, in part, that:

"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."

In a letter addressed to Governor Young under date of October 19, 1929, Governor Harding raised the question whether the uniform policy and the amendment to the regulation were intended to carry with them any implication that a Federal reserve bank may not make special arrangements with reference to collateral to insure the payment of checks in special cases. Opinions on this question were divided, and the subject was placed on the program for the next Governors' Conference. Upon consideration of this question, the Conference of Governors of all Federal reserve banks, at its meeting in December, 1929, voted as follows:

"VOTED That the conference is in agreement with the uniform policy approved by the Federal Reserve Board in its letter of October 16, 1929 (X-6389): that they are in favor of the amendment to Regulation J recommended by the majority of the Conference of Counsel; that they believe, however, it should be made clear in the regulation that any Federal reserve bank desiring to do so, may take collateral in order to protect itself only from liability as collecting agent."

The amendments now proposed to the regulation omit any reference to collateral and, therefore, clearly conform to the views of the Conference of Governors on this subject. I concur in the view of the Conference of Counsel, therefore, that the uniform policy, when read in connection with the vote taken by the Governors' Conference at its meeting in December, 1929, completely covers this subject and that no further interpretation of the uniform policy is necessary in view of the amendments now proposed to the regulation. In other words, the Governors' Conference in December, 1929, clearly concurred in Governor Harding's views on this subject; and, by adopting an amended regulation which makes no reference to collateral, the Board will also concur in his view; so that no further clarification of this point is necessary.

IMPORTANCE OF PROMPT ACTION.

I respectfully invite the Board's attention to the fact that these proposed amendments to Regulation J are designed to protect the Federal reserve banks against the possible dangers growing out of the decision of the Supreme Court in the case of Thomas A. Early, Receiver, v. Federal Reserve Bank of Richmond, and that every day's delay in the final promulgation of these regulations may result in substantial financial loss to the Federal reserve banks. It is, therefore, very important that these amendments to Regulation J be made effective as soon as possible and that every effort be made to expedite their final promulgation.

I, therefore, respectfully recommend that, unless the Board is willing to adopt these regulations without further consultation with the Federal reserve banks, the text of these proposed amendments be transmitted immediately to all Federal reserve banks with the request that each of them submit to the Board at the earliest possible date all criticisms and comments with reference thereto. If the replies received indicate no important differences of opinion, it would seem safe for the Board to promulgate the amended regulation and make it effective without awaiting formal consideration of a Conference of the Governors of the Federal reserve banks. On the other hand, if the replies received to this inquiry disclose important differences of opinion, then the Board can consider the advisability of delaying the final promulgation of the regulations until they have been considered formally by the Conference of Governors.

I believe that this procedure would be most likely to result in the promulgation of the regulation at the earliest possible date and at the same time afford sufficient safeguards against the adoption of a regulation which is not satisfactory to the great majority of the Federal reserve banks.

Respectfully,

Walter Wyatt,
General Counsel.

Papers attached

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Textual changes which would be made in Regulation J of Board's Regulations, Series of 1928, by amendments recommended by Conference of Federal Reserve Bank Counsel held in June, 1930, and by additional changes recommended by Messrs. Baker and Wyatt.

Present regulation is indicated by ordinary type.

Matter proposed to be stricken out is indicated by canceled wording.

Conference of Counsel recommendations are indicated by CAPITAL LETTERS.

Additional changes recommended by Messrs. Baker and Wyatt are indicated by CAPITAL LETTERS and are UNDERLINED.

SECTION III

Paragraph 1 of Section III would be changed as follows:

"(1) Each Federal reserve bank will receive at par from its member banks and from nonmember clearing banks in its district, checks drawn on all member and nonmember clearing banks, and checks drawn on all other nonmember banks which are collectible at par in funds acceptable to the COLLECTING Federal reserve bank. ~~of-the-district-in-which-such-nonmember-banks-are-located.~~"

Paragraph 3 of Section III would be changed as follows:

"(3) No Federal reserve bank shall receive on deposit or for collection any check drawn on any nonmember bank which can not be collected at par in funds acceptable to the COLLECTING Federal reserve bank ~~of-the-district-in-which-such-nonmember-bank-is-located.~~"

SECTION IV.

Paragraph 2 of Section IV would be changed as follows:

"(2) For all such checks as are received for immediate credit in accordance with such time schedule, immediate credit, subject to final payment, will be given upon the books of the Federal reserve bank at full face value in the reserve account or clearing account upon day of receipt, and the proceeds will at once be counted as reserve and become available for withdrawal or other use by the sending bank, PROVIDED, HOWEVER, THAT THE FEDERAL RESERVE BANK MAY IN ITS DISCRETION REFUSE AT ANY TIME TO

PERMIT THE WITHDRAWAL OR OTHER USE OF CREDIT GIVEN FOR ANY ITEM FOR WHICH THE FEDERAL RESERVE BANK HAS NOT YET RECEIVED PAYMENT IN ACTUALLY AND FINALLY COLLECTED FUNDS."

Paragraph 3 of Section IV would be changed as follows:

"(3) For all such checks as are received for deferred credit in accordance with such time schedule, deferred credit, subject to final payment, will be entered upon the books of the Federal reserve bank at full face value, but the proceeds will not be counted as reserve nor become available for withdrawal or other use by the sending bank until such time as may be specified in such time schedule, at which time credit will be transferred from the deferred account to the reserve account or clearing account subject to final payment and will then be counted as reserve and become available for withdrawal or other use by the sending bank, PROVIDED, HOWEVER, THAT THE FEDERAL RESERVE BANK MAY IN ITS DISCRETION REFUSE AT ANY TIME TO PERMIT THE WITHDRAWAL OR OTHER USE OF CREDIT GIVEN FOR ANY ITEM FOR WHICH THE FEDERAL RESERVE BANK HAS NOT YET RECEIVED PAYMENT IN ACTUALLY AND FINALLY COLLECTED FUNDS."

SECTION V.

This section would be amended to read as follows:

"SECTION V. TERMS OF COLLECTION

"The Federal Reserve Board hereby authorizes the Federal reserve banks to handle such checks subject to the following terms and conditions; and each member and nonmember clearing bank which sends checks to any Federal reserve bank for deposit or collection shall by such action be deemed (a) to authorize the Federal reserve banks to handle such checks subject to the following terms and conditions, (b) to warrant its own authority to give the Federal reserve banks such authority, and (c) to agree to indemnify any Federal reserve bank for any loss resulting from the failure of such sending bank to have such authority.

"(1) A Federal reserve bank will act only as agent of the bank from which it receives such checks and will assume no liability except for its own negligence and its guaranty of prior indorsements.

"(2) A Federal reserve bank may present such checks for payment or send such checks for collection direct to the bank on which they are drawn or at which they are payable, or in its discretion may forward them to another agent with authority to present them for payment or send them for collection direct to the bank on which they are drawn or at which they are payable."

"(3) A Federal reserve bank may, in its discretion and at its option, either directly or through OR FROM an agent, accept ~~either-cash-or-bank-drafts~~ in payment of or in remittance for such checks, CASH, BANK DRAFTS, TRANSFERS OF FUNDS OR BANK CREDITS, OR OTHER FORMS OF PAYMENT OR REMITTANCE, ACCEPTABLE TO THE COLLECTING FEDERAL RESERVE BANK. and THE FEDERAL RESERVE BANK shall not be held liable FOR THE FAILURE OF THE DRAWEE BANK OR ANY AGENT TO PAY OR REMIT FOR SUCH CHECKS, NOR for any loss resulting from the acceptance ~~of-bank-drafts~~ FROM THE DRAWEE BANK OR ANY COLLECTING AGENT, in lieu of cash, OF ANY OTHER FORM OF PAYMENT OR REMITTANCE AUTHORIZED HEREIN, ~~nor-for-the-failure-of-the-drawee-bank-or-any-agent-to-remit-for-such-checks~~, nor for the non-payment of, OR FAILURE TO REALIZE UPON, any bank draft ~~accepted-in-payment-or-as-a~~ OR OTHER MEDIUM OF PAYMENT OR remittance WHICH MAY BE ACCEPTED from the drawee bank or any COLLECTING agent."

"(4) Checks received by a Federal reserve bank ~~on-its-member-or-nonmember-clearing-banks~~ WHICH ARE PAYABLE IN ITS OWN DISTRICT will ordinarily be forwarded or presented direct to ~~such~~ THE banks, ON WHICH THEY ARE DRAWN, and such banks will be required to remit or pay therefor at par in ~~cash-or-bank-draft~~ SUCH ONE OR MORE OF THE FORMS OF PAYMENT OR REMITTANCE AUTHORIZED UNDER PARAGRAPH (3) HERE-OF AS MAY BE acceptable to the collecting Federal reserve bank, ~~or-at-the-option-of-such-Federal-reserve-bank-to-authorize-such-Federal-reserve-bank-to-charge-their-reserve-accounts-or-clearing-accounts.~~

"(5) Checks received by a Federal reserve bank payable in other districts will ORDINARILY be forwarded for collection ~~upon the-terms-and-conditions-herein-provided~~ to the Federal reserve bank of the district in which such checks are payable; PROVIDED, HOWEVER, THAT, WHERE ARRANGEMENTS CAN BE MADE SATISFACTORY TO THE COLLECTING BANK OR AGENT AND TO THE FEDERAL RESERVE BANK OF THE DISTRICT IN WHICH SUCH CHECKS ARE PAYABLE, ANY SUCH CHECKS MAY BE FORWARDED FOR COLLECTION DIRECT TO THE BANK ON WHICH THEY ARE DRAWN OR AT WHICH THEY ARE PAYABLE, OR MAY BE FORWARDED FOR COLLECTION TO ANOTHER AGENT WITH AUTHORITY TO PRESENT THEM FOR PAYMENT DIRECT TO THE BANK ON WHICH THEY ARE DRAWN OR AT WHICH THEY ARE PAYABLE. ALL SUCH CHECKS SHALL BE HANDLED SUBJECT TO ALL THE TERMS AND CONDITIONS OF THIS REGULATION.

"(6) BANK DRAFTS RECEIVED BY A FEDERAL RESERVE BANK IN PAYMENT OF OR IN REMITTANCE FOR CHECKS HANDLED UNDER THE TERMS OF THIS REGULATION SHALL LIKEWISE BE HANDLED FOR COLLECTION SUBJECT TO ALL THE TERMS AND CONDITIONS OF THIS REGULATION.

"(6) (7) 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 RESERVE BALANCE, CLEARING ACCOUNT, OR DEPOSIT ACCOUNT, OR OTHER SUCH FUND OF THE DRAWEE BANK OR OF ANY BANK TO WHICH SUCH CHECKS HAVE BEEN SENT FOR COLLECTION, IN THE POSSESSION OF THE FEDERAL RESERVE BANK. NO DRAFT, AUTHORIZATION TO CHARGE, OR OTHER ORDER UPON ANY RESERVE BALANCE, CLEARING ACCOUNT, DEPOSIT ACCOUNT, OR OTHER SUCH FUNDS OF A PAYING, REMITTING, OR COLLECTING BANK IN THE POSSESSION OF A FEDERAL RESERVE BANK, ISSUED FOR THE PURPOSE OF SETTLING ITEMS HANDLED UNDER THE TERMS OF THIS REGULATION WILL BE PAID, ACTED UPON, OR HONORED AFTER RECEIPT BY SUCH FEDERAL RESERVE BANK OF NOTICE OF SUSPENSION OR CLOSING OF SUCH PAYING, REMITTING, OR COLLECTING BANK."