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Dr. Miller

Mr. Vest - Assistant Counsel.

Board's rulings regarding Bankers' Acceptances

In accordance with your request, I have prepared the following memorandum showing the more important changes which the Board has made from time to time in the principles incorporated in its regulations and rulings with respect to bankers' acceptances. The memorandum is not intended to cover the lesser important rulings or regulations of the Board on this subject but its purpose is to give the facts with reference to those rulings of primary importance which represent changes in policy with regard to bankers' acceptances, and particularly as to those cases where such changes have involved a liberalization of the requirements.

ORIGINAL FEDERAL RESERVE ACT AND EARLY REGULATIONS AND RULINGS.

Under the provisions of the original Federal Reserve Act, Federal reserve banks were authorized by section 13 to discount acceptances based on the importation or exportation of goods with maturities of not more than three months, when indorsed by a member bank; and member banks were authorized to accept drafts or bills of exchange arising out of import and export transactions having not more than six months' sight to run. Federal reserve banks were also authorized by section 14 to purchase bankers' acceptances, with or without the indorsement of a member bank.

The Federal Reserve Board in 1915 issued several different regulations regarding bankers' acceptances, gradually expanding and enlarging the provisions with respect to their eligibility for rediscount. As a requisite of eligibility, it was required by the Board's rulings that there be a definite bona fide contract for the shipment of the goods involved in the import or export transaction within a specified and reasonable time after the making of the acceptance, and also that the transaction on account of which the acceptance is drawn must itself involve the importation or exportation of the goods in question.

One of the provisions contained in the Board's early regulations was that an acceptance must have been made "by a member bank, nonmember bank, trust company or by some private banking firm, person, company or corporation engaged in the business of accepting or discounting". This provision recognized as eligible for discount acceptances made, not only by banks and bankers, but also by others engaged in the acceptance business. A similar provision, though in different language, is contained in the present regulations regarding acceptances.

One of the most important of the early rulings on acceptances was one published in the 1915 Bulletin at page 91, in the form of an opinion of the Board's counsel, which held that Federal reserve banks were authorized to discount acceptances, as arising out of the

importation and exportation of goods, which were based on the shipment of goods between any two or more foreign countries and between the United States and certain of its dependencies and possessions, as well as between the United States and foreign countries. The Board's records do not indicate the circumstances under which this ruling was made. The substance of this ruling was subsequently incorporated in the Board's regulations and has been contained in the regulations since that time.

AUTHORITY FOR THE PURCHASE OR DISCOUNT OF ACCEPTANCES ARISING OUT OF DOMESTIC TRANSACTIONS.

In a regulation promulgated in November 1915, the Board authorized Federal reserve banks to purchase bankers' acceptances, when properly secured, covering the domestic shipment of goods or covering the warehouse storage of readily marketable staples. In transmitting this regulation, the Board stated that it had not felt justified, upon admitting State banks and trust companies to the Federal Reserve System, in requiring that they discontinue making acceptances arising out of domestic transactions if kept within reasonable limitations; and that the Board considered such acceptances as of a character to make desirable investments for Federal reserve banks. As uniformly construed by the Board, the authority of Federal reserve banks to purchase bankers' acceptances under section 14 of the Federal Reserve Act is not subject to the limitations applicable in the case of rediscounts of acceptances, and accordingly it was legally possible

to authorize Federal reserve banks by regulation to purchase domestic acceptances although no specific mention of domestic acceptances was made in the law. The Board's records do not disclose at whose instance or suggestion this authorization for the purchase of domestic acceptances was given.

Subsequently in the Act of September 7, 1916, the law was amended so as to authorize member banks to accept drafts or bills growing out of transactions involving the domestic shipment of goods provided shipping documents conveying or securing title are attached at the time of acceptance, or which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples; and Federal reserve banks were authorized to discount such acceptances. This amendment was recommended by the Federal Reserve Board in its annual report covering the year 1915, in which it was said, "There can be but little question of the safety of such acceptances, and their use will tend to equalize interest rates the country over and help to broaden the discount market".

Among the principal requirements which the Board has made in its regulations and rulings with respect to acceptances drawn against the storage of readily marketable staples is that the warehouse receipt covering such staples be issued by a party independent of the customer and that such acceptances should not have a maturity in excess of the time ordinarily necessary to effect a reasonably prompt sale, shipment or distribution into the process of manufacture or consumption. In connection with acceptances drawn to finance the domestic shipment of goods, the Board has held that there should be some actual connection between the acceptance of the draft and the transaction involving the shipment of the goods; that is, the draft should be drawn to finance the shipment. The Board has also said that a Federal reserve bank may properly decline to discount any acceptance the maturity of which is in excess of the usual or customary period of credit required to finance the underlying transaction or which is in excess of that period reasonably necessary to finance such transaction.

ACCEPTANCES TO FURNISH DOLLAR EXCHANGE.

The amendment of September 7, 1916, also authorized member banks to make, and Federal reserve banks to acquire, acceptances having not more than three months sight to run, drawn by banks or bankers in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange as required by the usages of trade.

The Federal Reserve Board adopted regulations requiring member banks which desire to accept drafts drawn by banks or bankers in certain countries for the purpose of furnishing dollar exchange to obtain the permission of the Board. Such permission is granted when the usages of trade in such countries appear to require such acceptance facilities. There have been no important changes in the regulations or in the law with respect to this subject since 1916.

ACCEPTANCES DRAWN UNDER CREDITS EXTENDING OVER A PERIOD OF ONE OR TWO YEARS.

Under date of February 7, 1918, the Board addressed a letter to the Governor of the Federal Reserve Bank of New York (published in the 1918 Bulletin at page 257), stating its policy in dealing with acceptances drawn under credits extending over a period of one or two years. The expression of the Board's policy on this subject was contained in a memorandum accompanying the letter. This letter and memorandum were prepared after correspondence with the Federal Reserve Bank of New York and after conferences between Governor Strong and a number of New York bankers. The principles outlined in the memorandum were summarized in the letter as follows:

> (1) Acceptance credits opened for periods in excess of ninety days should only, in exceptional cases, extend over a period of more than one year, and in no case for a time exceeding two years.
>
> (2) Banks which are members of groups opening these credits, should not buy their own acceptances, and where an agreement is made with the drawer for purchase of acceptances for future delivery, the rate should not be a fixed one, but

should be based upon the rate ruling at the time of the sale.

(3) Transactions covered by these credits should be of a legitimate commercial nature, and acceptances must be eligible according to the rules and regulations of the Board.

(4) Whenever syndicates are formed for the purpose of granting acceptance credits for more than moderate amounts, Federal reserve banks should be consulted with regard to the transaction. The question of eligibility, both from the standpoint of the character of the bill and of the amount involved, will be passed upon by the Federal reserve bank subject to the approval in each case of the Federal Reserve Board.

The introductory paragraph of the memorandum setting forth the principles above summarized is as follows:

"In dealing with the question of acceptances, it is desirable that the Board should not be obliged to adopt inflexible regulations unless absolutely necessary. It should be borne in mind that we are competing in the acceptance field with other countries which have no legal restrictions in which sound business judgment, guided from time to time by the central banks of these countries, constitutes the unwritten, but none the less rigid law. The banks of the United States would greatly assist the Board in its work of developing a modern and efficient system of American bankers' acceptances - and they would best serve their own purposes - if they would study and assimilate the underlying principles which must guide the Board, and observe these principles voluntarily without requiring inflexible rules. Unless the bankers cooperate with the Board in this manner, many transactions - unobjectionable as long as they are engaged in for legitimate purposes and within reasonable limits - will have to be barred because strict regulations do not admit of discrimination."

After a full discussion of the principles which are summarized above, the Board's memorandum concluded as follows:

"These are the principles which the Federal Reserve System must apply. It would be inexpedient to attempt more than to establish the principles. It would be detrimental to formulate definite regulations dealing in minute detail with the various phases of the problem. It would be far better to give some latitude to the banks in dealing with these matters. But this will depend entirely upon the wisdom and discretion of the member banks. The banks will best serve their own interests if, following the example of European institutions, they will adopt these principles as self-imposed, well tried rules of business

prudence rather than by abusing their freedom of action to force the Board to tie their hands by rigid regulations."

ACCEPTANCES AGAINST READILY MARKETABLE STAPLES STORED IN A WAREHOUSE IN A FOREIGN COUNTRY.

In 1919, the response to an inquiry from the Federal Reserve Agent at the Federal Reserve Bank of Boston the Board held that a member bank might properly accept a draft drawn in Canada, payable in the United States in dollars and secured by rice stored in a public warehouse in Canada, and that such an acceptance might properly be rediscounted by a Federal reserve bank. The Board's ruling on this question was published in the 1919 Bulletin at page 740.

PURCHASE OF EXPORT ACCEPTANCES WITH SIX MONTHS MATURITIES.

Under date of May 6, 1921, the Federal Reserve Board amended its Regulation B so as to authorize the purchase by Federal reserve banks of bankers' acceptances growing out of transactions involving the importation or exportation of goods with maturities up to six months. This increase in the maturities of such acceptances eligible for purchase was suggested in a letter to the Board from Deputy Governor Harrison of the Federal Reserve Bank of New York. The suggestion was also made in letters from Mr. Paul M. Warburg, in connection with the financing of so-called "finishing credits", a term used to designate a credit to finance both (1) the shipment from the United States of raw materials to be manufactured into finished products and (2) the subsequent process of manufacture in the foreign country and the exportation therefrom of the finished product. This amendment to Regulation B was recommended by

the Federal Advisory Council and also by the Governors of the Federal Reserve Banks.

In its letter transmitting the amended regulation, the Board said:

> Two considerations have led the Board to take this action: (1) The desire to widen the acceptance market by meeting the wants of savings banks and similar purchasers of bankers' acceptances who are now deterred from investing in acceptances of longer than three months' maturity, because of the lack of authority of Federal Reserve Banks to purchase longer maturities up to six months; (2) to provide more ample facilities for financing import and export trade with countries where either normal conditions or present abnormal conditions indicate the desirability of rendering assistance by making acceptances of maturities not exceeding six months eligible for purchase by Federal Reserve Banks.

The Board also stated that it looked to the good banking judgment and discretion of the accepting banks and of the Federal Reserve Banks to avoid any untoward results; and that the effect of this widening of the investment powers of the Federal reserve banks would be followed closely with a view to such modification of the regulations as might be necessary.

Under the Board's present regulation, Federal reserve banks may purchase bankers' acceptances growing out of transactions involving the importation or exportation of goods with maturities not in excess of six months.

PURCHASE OF ACCEPTANCES DRAWN BY COOPERATIVE MARKETING ASSOCIATIONS WITH SIX MONTHS' MATURITIES.

Under date of December 19, 1922, the Federal Reserve Board promulgated an amendment to its Regulation B authorizing Federal reserve banks to purchase bankers' acceptances, with maturities not in excess of

six months, which are drawn by growers or by cooperative marketing associations composed exclusively of growers of nonperishable, readily marketable, staple agricultural products, to finance the orderly marketing of such products grown by such growers and secured at the time of acceptance by warehouse, terminal or other similar receipts issued by parties independent of the borrowers and conveying security title to such products.

The Board's records do not indicate upon whose suggestion or recommendation this change in its regulation was made; but the Board stated in its letter of transmittal:

> "The Board was moved to take this action by a desire to provide more ample facilities for financing the orderly marketing of staple agricultural products, especially by cooperative marketing associations. This is in accordance with the principle heretofore recognized by the Board that the carrying of agricultural products for such periods as are reasonably necessary in order to assist the orderly marketing thereof is a proper step in the process of distribution."

By the Act of March 4, 1923, Federal Reserve Banks were authorized to <u>discount</u> acceptances with maturities up to six months when drawn for an agricultural purpose and secured at the time of acceptance by documents of title covering readily marketable staples.

ELIMINATION OF DOCUMENTARY REQUIREMENTS AS TO ACCEPTANCES GROWING OUT OF IMPORT AND EXPORT TRANSACTIONS.

Under date of March 29, 1922, the Board promulgated an amendment to its Regulation A, eliminating the requirements for the attachment or furnishing of documents in connection with acceptances arising out of import and export transactions, and leaving

eligibility to be determined by the Federal reserve banks as a question of fact.

Simplification of the Board's regulations regarding bankers' acceptances had been recommended in May, 1921 by the Federal Advisory Council in a statement as follows:

> * * * * "Moreover, it is impossible for the American bankers' acceptance to establish itself in competition with the British sterling acceptance in world markets if the foreign drawer is bewildered by a mass of regulations which he has to understand fully if he is to be certain that he is issuing an eligible bill which will find a ready market in the United States. The simpler the regulations the better the opportunity for the American bankers' acceptance to become a credit instrument in world markets. If there are competent men whose discretion may be relied upon in charge of the supervision of American acceptors, there is no need for attempting to control by detailed regulations the practice of American accepting banks and bankers. "

It was presumably on the basis of this recommendation that the matter was given consideration by the Board in March, 1922, but the record does not show whether this is a fact. Shortly before the adoption of the amended regulation by the Board, the proposed change eliminating the documentary requirements was discussed at an informal conference in New York by Governor Harding and Mr. Logan with Messrs. Warburg, Kent, Broderick, Kenzel and Harrison. There was apparently another discussion of the matter a few days later by Mr. Kenzel and certain New York bankers with the Federal Reserve Board. Before the change in the regulation was adopted a number of the Federal reserve banks, as well as the President of the Advisory Council,

were asked for their views with respect to the matter.

The Board's letter of transmittal of this amendment to Regulation A stated that there had been a rapid growth of the acceptance business during the war and it had been necessary accordingly for the Board to make frequent rulings and to amend its regulations regarding bankers' acceptances periodically; the Regulation of 1920 on this subject was the last step in the development of such regulations and it contained the substance of the more important rulings previously issued by the Board regarding acceptances arising out of import and export transactions. In view of the experience which the American banks had obtained, the Board considered that detailed regulations on this subject were no longer necessary and also that the general advancement of foreign trade could be furthered most effectually by the substitution of a simpler regulation. Accordingly, the Board eliminated the following sentences from its regulation with respect to acceptances arising out of import and export transactions:

> * * * "While it is not necessary that shipping documents covering goods in the process of shipment be attached to drafts drawn for the purpose of financing the exportation or importation of goods, and while it is not essential, therefore, that each such draft cover specific goods actually in existence at the time of acceptance, nevertheless it is essential as a prerequisite to eligibility either (a) that shipping documents or a documentary export draft be attached at the time the draft is presented for

> acceptance, or (b) if the goods covered by the credit have not been actually shipped, that there be in existence a specific and bona fide contract providing for the exportation or importation of such goods at or within a specified and reasonable time and that the customer agree that the accepting bank will be furnished in due course with shipping documents covering such goods or with exchange arising out of the transaction being financed by the credit. A contract between principal and agent will not be considered a bona fide contract of the kind required above, nor is it enough that there be a contract providing merely that the proceeds of the acceptance will be used only to finance the purchase or shipment of goods to be exported or imported.

In making this amendment, the Board stated that it was not reversing or modifying its former rulings, which were regarded as essential to the proper conduct of the acceptance business, but that its action was intended merely to allow greater latitude to Federal reserve banks for the exercise of their discretion and judgment, observing always the limitations of the law. The Board also stated that the responsibility for passing upon the eligibility of bankers' acceptances rests upon the Federal reserve banks themselves and each bank should satisfy itself that the acceptances conform to the requirements.

ACCEPTANCES BY NATIONAL BANKS AGAINST IMPORT AND EXPORT BILLS.

In rulings published in the 1917 Bulletin at page 28 and in the 1920 Bulletin at page 610, the Board took the position that no bank which has purchased a foreign documentary draft may refinance itself by drawing a draft on a member bank secured by the documentary draft. The theory underlying these rulings was that such a draft is not drawn for the purpose of financing the importation or exportation of goods but for the purpose of financing the business of the bank which purchased the foreign documentary draft.

During the year 1923, the Board had correspondence with Mr. J. H. Fulton, President of the National Park Bank of New York with reference to the right of a national bank to accept drafts against the security of import or export bills, and also had correspondence with the Federal Reserve Bank of New York on this question. The Federal Reserve Bank considered that acceptances of this kind under proper conditions would be lawful, but it was the Board's position at that time that such acceptances were not proper under the rulings above referred to. In 1924, letters were addressed to the Board by the Governors of the Federal Reserve Banks of New York and San Francisco requesting a final ruling of the Board with respect to this question. The Board gave further consideration to the subject, but for some reason no action was taken at that time. In 1926, however, acceptances of this kind were questioned by a national bank examiner in an examination of the First National Bank of Boston and the Comptroller of the Currency asked

the Federal Reserve Board for a ruling in the matter. The Board again gave consideration to the question and reached the conclusion that its former rulings on the subject contained an unnecessarily strict interpretation of the law. Accordingly, the Board ruled that national banks may legally accept drafts drawn upon them by other banks against the security of import or export bills of exchange previously discounted by such other banks; provided that such drafts are drawn before the underlying import or export transactions are completed and comply as to maturity and in all other respects with the provisions of the law and the Board's regulations. (1926 Bulletin 854).

ACCEPTANCES AFTER IMPORT OR EXPORT TRANSACTION COMPLETED.

At a meeting of the Subcommittee of the General Acceptance Committee held in New York in October, 1927, it was decided to recommend to the Federal Reserve Board that the Board revoke its previous rulings to the effect that a bill cannot be eligible for acceptance by a member bank, or for rediscount or purchase by a Federal reserve bank, as a bill growing out of the importation or exportation of goods, if it is accepted after the goods have reached their destination; and to rule in lieu thereof that bankers' acceptances may properly be considered as growing out of transactions involving the importation or exportation of goods when given for the purpose of financing the sale or distribution on usual credit terms of imported or exported goods into the channels of trade, whether or not the bills are accepted after the physical importation or exportation has been completed.

Shortly before the meeting referred to, Mr. Kenzel, Chairman of the Sub-committee, had appeared before the Federal Reserve Board, in response to an invitation from the Board, to discuss possible amendments to the Board's regulations and rulings regarding bankers' acceptances, and had pointed out the desirability of making a ruling of this kind in order that American acceptances might compete with those of other countries in financing foreign trade.

Subsequent to his appearance before the Board in this connection, Mr. Kenzel conferred with a number of prominent New York bankers engaged in the acceptance business; and the following is an excerpt from his statement on this subject submitted in connection with the recommendation of the sub-committee:

> "They (the bankers consulted) felt that they would not wish to extend credits in Europe for purely domestic purposes, explaining that by that they meant the purchase of goods of domestic origin, the fabrication of such goods and its sale for domestic consumption within any European country, but that they did feel that they should be permitted to finance through acceptance credits the sale within European countries of goods of origin foreign to those countries, and the fabrication and sale of goods for export. Many of them cited the familiar problem of American cotton which is now sent so largely to European countries on consignment by American shippers and is sold to European spinners out of warehouses in Europe. Spinners require credit of ninety days or more. Under the present rules, American banks can give such credits where the cotton crosses a frontier in Europe, that is, where it is exported from one European country to another, but they cannot give such credits if the cotton is sold to spinners located in the same European country in which it is stored pending sale.

"A similar negative position arises with respect to cotton which is sold and shipped from America on terms that have become quite usual, i.e., that at the buyer's option he may pay cash on arrival or give ninety days bankers credit. It frequently happens that the cotton has arrived and so the physical export completed before the buyer elects how he shall pay. If he elects to give ninety days bankers credit the banker may not accept the bill if the cotton has arrived at the foreign destination named in the shipping documents."

"The American bankers consulted felt that the time has certainly arrived in the development of American acceptance business when American accepting bankers should be permitted the free exercise of their discretion within the law and regulations and that, within those limits, full latitude should be granted them in the accommodation of business as it is done in foreign countries. They stressed particularly the point that they regarded it as preferable to give a three months credit with a renewal for a further period, if it were found that a renewal were required at the expiration of the original period, than to grant the credit originally for a period of six months, and that if the rule against accepting a bill after the goods had arrived were rescinded, the end sought would be practically accomplished without a specific ruling in favor of renewal bills. It was pointed out that from the bankers' point of view it was preferable to be able to review credits at more frequent intervals than is the case when credits up to six months are being insisted upon by the borrower as a precaution against being unable to redraw at the end of a shorter period in case of need even for a small part of the credit".

The recommendation made by the subcommittee was considered by the Federal Advisory Council and, with one suggested change, was

approved. After consideration of the matter, the Board reached the conclusion that its previous rulings on this subject contained an unnecessarily strict interpretation of the law; and, in order to facilitate the financing of foreign trade and the sale of American goods abroad, the Board ruled, on November 28, 1927, (1927 Bulletin, p. 860) that bankers' acceptances may properly be considered as growing out of transactions involving the importation or exportation of goods when drawn for the purpose of financing the sale and distribution on usual credit terms of imported or exported goods into the channels of trade, whether or not the bills are accepted after the physical importation or exportation has been completed. The Board pointed out that due care should be observed to prevent a duplication of financing and that there should not be outstanding at any time more than one acceptance against the same goods. This ruling of the Board reversed all previous conflicting rulings.

ACCEPTANCES DRAWN BY WAREHOUSE OR ELEVATOR COMPANY AGAINST WAREHOUSE RECEIPTS ISSUED BY ITSELF.

In 1924, Governor Young of the Federal Reserve Bank of Minneapolis suggested to the Federal Reserve Board that it give approval to acceptances drawn by a terminal elevator company against the security of warehouse receipts issued by the company which draws the acceptances. He pointed out that in Minnesota such a company is under the strict supervision and control of a State commission, a representative of which checks all grain that is stored in the elevator and all grain that is removed therefrom; and that it is practically impossible to remove grain from such terminal elevators without the knowledge and permission of the representa-

tive of the State commission.

The matter was considered by the Federal Reserve Board from time to time over a period of several years and was twice referred to the Governors' Conference, which recommended that the Board approve acceptances of this character. After consideration of the matter, the Board in April, 1927, voted to disapprove the recommendation of the Governors' Conference and not to amend its regulations so as to make such acceptances eligible for rediscount or purchase by the Federal reserve banks. The Board considered that the principle laid down in its regulations, that warehouse receipts used as security for acceptances must be issued by a party independent of the customer, was essential to the maintenance of the high standard of bankers' acceptances and that any action setting aside this principle might establish a precedent for future action which would result in the lowering of the standard.

The matter was again considered by the Federal Reserve Board in October 1928, however, at which time Governor Young was Governor of the Federal Reserve Board, and the Board decided to adopt an amendment to its regulations making eligible for rediscount or purchase acceptances against warehouse receipts conveying security title to readily marketable staples when such receipts are "issued by a grain elevator or warehouse company duly bonded and licensed and regularly inspected by State or Federal authorities with whom all receipts for such staples and all transfers thereof are registered and without whose consent no staples may be withdrawn."

LIBERALIZATION OF RULINGS REGARDING DOMESTIC BANKERS' ACCEPTANCES.

The General Committee on Bankers' Acceptances at its meeting in March, 1926, adopted a report containing a statement of broad general principles regarding correct practices in the granting of domestic bankers' acceptance credits and recommending specifically that the use of domestic acceptances be broadened, particularly in two respects:

(1) To permit the purchaser of goods under bankers' acceptance credits to draw bills having a maturity consistent with the usual and customary credit time that obtains in the relative trade, instead of requiring the shipper to draw the bill if it has a maturity in excess of the actual transit time of the goods, (the Board's rulings had been understood as making a distinction between the period for which acceptances may be drawn by the seller and the period for which they may be drawn by the purchaser);

(2) To permit the use of bankers' acceptances secured by receipts covering readily marketable staples to finance the carrying of certain staples during the time they are being converted into other forms of readily marketable staples through a converter independent of the drawer, provided that the identity of the goods is not lost and the accepting bank remains secured by the independent converter's receipt.

This report of the General Committee on Bankers' Acceptances was considered by the Governors' Conference in March, 1926, which approved the report and requested the Federal Reserve Board to adopt the rulings contained therein. The Federal Reserve Board acted upon the matter in June, 1928, at which time it approved the report in so far as it contained a statement of the broad general principles regarding correct practices in the granting of domestic bankers' acceptance credits, but with the understanding that such approval should not be construed as revoking or qualifying any of the Board's existing rulings. The Board stated that if the broadened use of domestic bankers' acceptances was found to be hampered by the existing rulings of the Board, it would consider the question of revoking or modifying such rulings provided a statement of specific facts arising in actual cases was submitted to the Board.

The Governors' Conference in November 1928, upon consideration of a report of the subcommittee of the General Committee on Bankers' Acceptances, requested the subcommittee to submit to the Board specific examples of transactions exemplifying the need for a modification of the Board's rulings in the respects above mentioned. This was done and the following is an example of the facts submitted with regard to the Committee's first recom-

mendation:

> "A firm in New York City purchases certain staples from a seller in a western city who ships the same and draws a sight draft on the purchaser in New York with bill of lading attached. This draft and bill of lading attached are sent in the customary way to a bank in New York, Bank A, designated by the purchaser. The latter then draws a 90 day bill on Bank A, which is accepted by the bank, having at the time in its possession the bill of lading covering the staples in process of shipment. The acceptance is then discounted by the purchaser and the proceeds used to pay the sight draft and to obtain the release of the bill of lading. It does not require 90 days for the completion of the shipment of goods, only a relatively short time being necessary for this purpose."

After consideration, the Board ruled in November 1929 that a draft drawn by the purchaser of goods in accordance with the facts above stated is eligible for acceptance by a member bank when it has a maturity consistent with the usual and customary credit time prevailing in the particular business, provided that all other relevant requirements of the law and of the Board's regulations are complied with. (1929 Bulletin, page 811).

This ruling was in some respects inconsistent with certain previous rulings of the Federal Reserve Board to the effect that an acceptance should not be drawn for the purpose of furnishing working capital to the borrower or to the purchaser during the process of the manufacture of goods; and the Board stated that such previous rulings with regard to working capital might be regarded as superseded by this ruling to the extent of any such inconsistencies.

The subcommittee also submitted an example of a specific case designed to show the desirability of permitting the use of bankers' acceptances, secured by receipts covering readily marketable staples, to finance the carrying of these staples during the time they are being converted into other forms through a converter or processer who is independent of the drawer of the acceptance, provided that the identity of the goods is not lost and the accepting bank remains secured by the independent converter's receipt. After consideration, however, the Board voted in March 1930, to disapprove the recommendation made on this point and stated its opinion that bills drawn under such circumstances are not to be considered as eligible for acceptance by member banks.

BOARD'S POLICY OF RULING ON ACCEPTANCE QUESTIONS ONLY AFTER CONSIDERATION OF FEDERAL RESERVE BANKS.

It has been the policy of the Federal Reserve Board for a number of years not to consider and pass upon questions with regard to

bankers' acceptances until such questions have been first submitted to and considered by the Federal reserve bank of the district in which the question arises. It is not clear when this policy was first adopted but it was definitely in force as early as 1922 and probably, at least in some cases, for some time before that.

Many acceptance questions, of course, have arisen in the New York District and accordingly the Federal Reserve Bank of New York has been frequently called upon to consider such questions; and much of the Board's correspondence regarding acceptance matters has been with this Federal reserve bank. In a number of cases where acceptance questions have arisen in other districts, the Federal Reserve Board in considering such questions has taken them up either formally or informally with Mr. Kenzel, the Chairman of the Committee on Bankers' Acceptances.

SUMMARY

For convenient reference there is given below a brief summary of the changes in the law, regulations and rulings regarding acceptances, which have been discussed above.

Provisions of the Federal Reserve Act.

Under the original Federal Reserve Act, member banks were authorized to accept drafts arising out of import and export transactions having not more than six months' sight to run and Federal reserve banks were authorized to discount such acceptances, indorsed by a member bank, with maturities of not more than three months. Federal reserve banks were also authorized to purchase bankers' acceptances with or without the indorsement of a member bank.

By the Act of September 7, 1916, member banks were authorized to make, and Federal reserve banks to discount, acceptances arising out of the domestic shipment of goods or out of the storage of

readily marketable staples; and by this Act, also, member banks were authorized to make, and Federal reserve banks to acquire, acceptances drawn for the purpose of furnishing dollar exchange.

By the Act of March 4, 1923, Federal reserve banks were authorized to discount acceptances with maturities up to six months when drawn for an agricultural purpose and secured at the time of acceptance by documents of title covering readily marketable staples.

Rulings and Regulations of the Federal Reserve Board.

In its regulation of February 8, 1915, the Board recognized as eligible for rediscount acceptances made, not only by banks and bankers, but also by others engaged in the acceptance business.

In a ruling published in the 1915 Bulletin at page 91, the Board gave approval to acceptances based on the shipment of goods between two or more foreign countries and between the United States and certain of its dependencies and possessions, as well as between the United States and foreign countries.

By regulation dated November 29, 1915, the Board authorized Federal reserve banks to purchase bankers' acceptances, when properly secured, covering the domestic shipment of goods or covering the warehouse storage of readily marketable staples. (This was prior to the amendment to the law permitting the discount of domestic acceptances.)

After the amendment to the law of September 7, 1916, the Board included in its regulations provisions regarding the acceptance by member banks of drafts drawn to furnish dollar exchange.

Under date of February 7, 1918, the Board addressed a letter to the Governor of the Federal Reserve Bank of New York stating its policy in dealing with acceptances drawn under credits extending over a period of one or two years.

In a ruling published in the 1919 Bulletin at page 740, the Board approved acceptances drawn in a foreign country payable in the United States in dollars and secured by staples stored in a foreign warehouse.

Under date of May 6, 1921, the Board amended its regulations so as to authorize the purchase by Federal reserve banks of bankers' acceptances growing out of transactions involving the importation or exportation of goods with maturities up to six months.

Under date of December 19, 1922, the Board amended its regulations so as to authorize Federal Reserve Banks to purchase bankers' acceptances with maturities not in excess of six months which are drawn by agricultural growers or by cooperative marketing associations and are properly secured.

On March 29, 1922, the Board amended its regulations so as to eliminate the requirements for the attachment or furnishing of documents in connection with acceptances arising out of import and export transactions.

By ruling published in the 1926 Bulletin at page 854, the Board held that national banks may legally accept drafts drawn upon them by other banks against the security of import or export bills of exchange previously discounted by such other banks provided that such drafts are drawn before the underlying import or export transactions are completed.

The Board ruled on November 28, 1927, that bankers' acceptances may properly be considered as growing out of import or export transactions when drawn for the purpose of financing the sale and distribution on usual credit terms of imported or exported goods into the channels of trade, whether or not the bills are accepted after the physical importation or exportation has been completed.

On October 9, 1928, the Board amended its regulations so as to make eligible for rediscount or purchase acceptances against warehouse receipts issued by grain elevator or warehouse companies duly bonded and licensed and regularly inspected by State or Federal authorities with whom all receipts for such staples and all transfers thereof are registered and without whose consent no staples may be withdrawn.

By a ruling published in the 1929 Bulletin at page 811, the Board ruled that a draft drawn by the purchaser of staples to finance the shipment of such staples is eligible for acceptance when it has a maturity consistent with the usual and customary credit time prevailing in the particular business.

On March 19, 1930, the Board stated its opinion that bills drawn for the purpose of financing the carrying of staples during the time they are being processed or converted are not eligible for acceptance.

It has been the policy of the Board for a number of years to consider and pass upon acceptance questions only after they have first been considered by a Federal reserve bank.

Respectfully,

George B. Vest,
Assistant Counsel.