

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-7454

June 13, 1933.

SUBJECT: Topic for Conference of Governors:
Federal Reserve Exchange drafts
and Transfer drafts.

Dear Sir:

There are inclosed herewith for your information two copies of a memorandum addressed to the Board on the question whether the privilege of issuing Federal reserve exchange drafts and Federal reserve transfer drafts should be withdrawn.

The Board is desirous of discussing this question with the Governors of the Federal reserve banks at their next conference, and the matter is hereby made a topic for inclusion in the program of the conference.

Very truly yours,

Chester Morrill
Secretary

Inclosures.

TO THE GOVERNORS OF ALL FEDERAL RESERVE BANKS.

May 31, 1933.

To: The Federal Reserve Board.

Subject: Suggested topic for Governors' Conference: - Federal reserve exchange and transfer drafts.

From: Mr. Chase - Assistant Counsel.

The question has been raised as to the desirability of withdrawing the privilege now held by member banks of issuing Federal reserve exchange drafts and Federal reserve transfer drafts; and it has been suggested that this question be given consideration by the Conference of Governors of the Federal reserve banks.

On February 21, 1933, the Governor of the Federal Reserve Bank of San Francisco telegraphed to the Board as follows:

"In view of the uncertainties of our legal obligation in connection with payment or dishonor of Federal Reserve exchange and transfer drafts in event of suspension of drawer it is our belief that we should withdraw the privilege. Banks availing themselves of use of exchange and transfer drafts are very few and under present conditions it is believed the service is not warranted for the risks involved. Suggest reference to be made to correspondence passing between Wyatt and Agnew on this subject. Use of Federal Reserve exchange and transfer drafts was directed by Federal Reserve Board under date April 25, 1917 see letter X-102."

Under date of March 2, 1933, the following reply was sent:

"Your wire February 21 regarding privilege of issuing Federal reserve exchange and transfer drafts. In view of questions raised in correspondence referred to it appears that subject is one to which consideration should be given as a matter of system policy by Governors' Conference. Question as to what action should be taken in meantime with respect to withdrawal of privilege in individual cases is one which Board feels should be considered carefully in the light of any disturbance that might be caused in present circumstances but if after such consideration bank feels justified in withdrawing privilege in particular cases Board will not object. Copies of correspondence are being sent to all other Governors for their information in advance of next conference."

However, in view of the then existing banking emergency, and since it was necessary to obtain additional data by correspondence, the matter could not be submitted to the Governors for their consideration in advance of their next conference, which was held on April 19, 1933; and no time was available during that conference to consider it.

For the information of the Board, the facts relating to this matter are set out in this memorandum.

ORIGIN AND NATURE OF THESE DRAFTS

The use of Federal reserve transfer drafts and Federal exchange drafts was inaugurated in 1917, pursuant to the Board's letter of April 25, 1917, (X-102) and the inclosed memorandum and forms (X-92 to X-96, Incl.) copies of which are attached hereto. As stated in that memorandum, the nature of these drafts is as follows:

A Federal reserve transfer draft is drawn by a member bank on its own Federal reserve bank and is payable only upon receipt of advice from the drawee Federal reserve bank by the Federal reserve bank at which it is payable.

A Federal reserve exchange draft is drawn by a member bank on its own Federal reserve bank and is receivable for immediate availability at par at any Federal reserve bank, although actually payable only at the drawee Federal reserve bank.

In connection with both types of draft, it was contemplated that the drawee Federal reserve bank, immediately upon receipt of advice that the draft had been drawn, would transfer the amount of the draft from the drawer's account to a special account for the

-3-

payment of the draft when presented. This feature distinguishes these drafts from ordinary drafts, in connection with which no such transfer is made.

At first, the maximum amount for which an Exchange draft could be drawn was limited to \$250. This limit was later increased to \$5,000 (see copy of Board's letter of August 12, 1918, X-1121, attached hereto) and is now \$50,000 (see copy of Board's letter of June 19, 1925, X-4362, attached hereto). The minimum amount for which a Transfer draft may be drawn is \$250.

As is shown by the above memorandum (X-92), the drawing of these drafts was intended to be a privilege supplementary to the right of drawing ordinary bank drafts upon Federal reserve banks, and it was apparently originally contemplated that the privilege would be extended to all member banks.

In view of the fact that Exchange drafts were subject to immediate availability, the Federal reserve banks adopted the practice of granting the privilege of drawing such drafts only to member banks whose applications for the privilege had been approved by the Federal reserve bank. The Board recognized this practice, as is shown by its letter of June 19, 1925 (X-4362). As an illustration of this practice there is attached hereto a copy of Circular 69 of August 29, 1925, of the Federal Reserve Bank of San Francisco. In some cases the privilege of drawing Transfer drafts was likewise limited to banks whose applications for the privilege had been approved.

-4-

UNCERTAINTIES AS TO LEGAL RIGHTS IN CONNECTION
WITH THESE DRAFTS.

As the number of bank failures increased, it became apparent that certain troublesome questions arose in connection with these drafts in the event of the insolvency of the drawer bank; and in order to obtain the views of the other Federal reserve banks, Mr. Agnew, Counsel for the Federal Reserve Bank of San Francisco, suggested to Mr. Hale, Cashier of that bank, that he address a letter to the other Federal reserve banks stating a number of these questions. A copy of Mr. Hale's letter, dated December 2, 1932, is attached hereto.

In a letter to the Board's General Counsel dated February 2, 1933, Mr. Agnew stated that the principal legal question underlying the various questions asked by Mr. Hale was:

"Does the issuance of an exchange draft by a member bank, the receipt of notice of such issuance by a Federal Reserve Bank and the charging of the draft by the Federal Reserve Bank to the member bank's account constitute such segregation and assignment of the funds necessary to pay the draft as to require the Federal Reserve Bank to honor and pay the draft upon presentation, even after notice of insolvency of the drawer?"

Replies to Mr. Hale's letter were received from almost all of the Federal reserve banks. Copies of these replies are attached hereto. Although not all of the replies state a definite conclusion, the majority express the opinion that the answer to the underlying question stated by Mr. Agnew is that, after receiving advice that the draft has been issued and after transferring funds from the account of the drawer bank to a special account for the payment of the draft, the drawee Federal reserve

-5-

bank should not use the funds for any other purpose, and is justified in using them for the purpose of paying the draft even after notice of the insolvency of the drawer. The reasoning upon which this conclusion is reached, with which I am in agreement, is stated as follows by Mr. Wallace in his memorandum dated December 20, 1932 (which is attached hereto accompanying the reply of the Federal Reserve Bank of Richmond to Mr. Hale's letter).

"Applying the principles of the above cases to our Circular No. 142 relating to the issuance of Federal Reserve Exchange drafts, I am inclined to the opinion that Federal Reserve Exchange drafts issued under the circular are clearly assignments of the fund against which they are drawn, or rather that the advice of drawing which the drawer bank must give is sufficient to constitute an assignment when read in connection with the circular, for in that case it is plain that the drawer of the draft is placed upon notice that when the draft is drawn and the advice given, its account will be charged. The circular states that Federal Reserve drafts are entirely different from ordinary drafts and are intended to serve a different purpose. The circular indicates that this difference is because ordinary drafts drawn on Federal reserve banks are payable only on presentation, and consequently will not be received by other Federal reserve banks for immediate credit, but that the Federal Reserve Exchange drafts will be received for immediate credit at par by any other Federal reserve bank or branch subject, of course, to final payment by the Federal reserve bank on which they are drawn."

Mr. Parker, counsel for the Federal Reserve Bank of Atlanta and Mr. McConkey, counsel for the Federal Reserve Bank of St. Louis, also reach this conclusion, adding that in their opinion the transaction is analogous to one where the drawee bank issues its cashier's

-6-

check or certifies the original check. (Copies of the memoranda of Mr. Parker and Mr. McConkey are attached hereto accompanying the replies of their Federal reserve banks to Mr. Hale's letter)

The conclusion stated above, however, does not dispose of questions which may arise affecting the Federal reserve bank to which an Exchange draft is presented for payment, since that bank may not know definitely (a) whether the drawer has notified the drawee Federal reserve bank, or (b) whether the drawee bank has actually made the transfer on its books after receiving such notice, either because it was not in possession of sufficient funds with which to make the transfer or for any other reason. In either event, the reasoning upon which the conclusion stated above is based would obviously be inapplicable, and the Federal reserve bank to which the draft was presented for payment might therefore be faced with a loss if it paid the draft on presentation.

Mr. Wallace discusses this question at some length in his letter of February 14, 1933 to Mr. Arnew, a copy of which is attached hereto. Of course, if the Federal reserve bank to which the draft is presented for payment were to delay payment until it had communicated with the drawee Federal reserve bank and ascertained that funds were unconditionally available, all these questions might be avoided, although it would seem that this procedure might in some cases be in conflict with the provisions of the circular, and the statement appearing on the face of the draft itself, that the funds are subject to immediate availability. Moreover, as Mr. Wallace

-7-

points out in his letter to Mr. Agnew, a refusal to honor the draft, no matter what the circumstances, would be most undesirable from the standpoint of the effect which such action would have upon the persons dealing with Federal reserve banks, since the terms of the draft would indicate, at least to an ordinary business man, that the Federal reserve bank had in effect promised that the funds would be immediately and unconditionally available. Technically, neither the paying nor the drawee Federal reserve bank might be liable as a matter of law because the draft had not been accepted by the drawee, but the result might be hardship and practical injustice to the person receiving the draft. Mr. Wallace goes on to say:

"The operating officers of the bank tell me that these drafts are not used to any large extent by our member banks. In transfers from one bank to another it is more convenient to use the wire transfer. I understand that the drafts are largely used when some individual wishes to purchase from a country bank exchange payable at some point at which the bank has no correspondent. Therefore, as Mr. Clements pointed out, it seems that the chief use of the drafts at present is in the very class of transactions in which their use is likely to mislead the public, and it is far from improbable that they may do more harm than good when used under present conditions.

"You understand, of course, that I have not discussed this matter with the senior officers of the bank and consequently what I have said is merely an expression of my individual views; but I am very positive that from the standpoint of a lawyer, if the use of these drafts is continued the circulars under which they are issued and the forms of the drafts should be carefully reviewed in the light of the experience which we have had in the past few years. One of the operating officers of the bank suggested to me that if no other revision was made, the form of the draft should at least be revised to the extent of changing the phraseology which indicates that any Federal reserve bank will receive this draft for immediate availability at par and the following words added: 'Subject nevertheless to payment by the Federal reserve bank upon which it is drawn'."

-8-

LITTLE USE IS MADE OF THESE DRAFTS

All of the replies which make any comment as to the extent to which transfer drafts and exchange drafts are now used, indicate that at the present time their use is very limited (see replies of Federal Reserve Banks of New York, Atlanta, Chicago, St. Louis and San Francisco), and in some cases has been entirely discontinued (see replies of Federal Reserve Banks of Kansas City and Minneapolis). The principal reason given for their disuse is the practice, which was inaugurated after the inauguration of these drafts in 1917, of making free telegraphic transfers of funds, thus rendering the privilege of issuing these drafts of little practical value.

Several of the replies suggest that, in view of the small extent to which these drafts are used and in view of the danger that their use may result in financial loss or litigation to the Federal reserve banks, it would be advisable to discontinue the use of drafts of both types.

For instance, in his letter of February 2, 1933 to the Board's General Counsel, Mr. Agnew said:

"It seems to me, and to the officers of the Federal Reserve Bank of San Francisco, that the right to the use of exchange and transfer drafts is superfluous and that without imposing any hardship upon member banks or curtailing the facilities offered by the Federal Reserve System to any appreciable extent, their use could be discontinued."

In his letter of February 14, 1933, to Mr. Agnew, Mr. Wallace said:

"I have been considering your suggestion that the use of these drafts should be discontinued, and while I have not had an opportunity to discuss all phases of the situation with the executive officers of the bank, I myself have come to the conclusion that the whole subject is so full of doubtful questions, both of law and policy, that it would certainly be advisable either to discontinue the use of the drafts, or at least to review the situation carefully and endeavor to eliminate some of the weak spots in the system as it operates at present.

The replies to Mr. Hale's letter also contain other similar expressions of opinion.

It appears moreover from the replies to Mr. Hale's letter that there are other matters not discussed in those replies which it would be advisable to discuss in connection with these drafts in the event that it is not decided to withdraw the privilege of issuing them. For instance, Mr. Coleman, Deputy Governor of the Federal Reserve Bank of Dallas states at the conclusion of his reply to Mr. Hale's letter that:

"There are quite a number of questions that immediately occur to one in considering this matter and it would not be practicable in a letter of this kind to attempt to discuss all of them. We do believe that the matter as now handled in the Federal Reserve System is susceptible to much improvement, and we should be glad to join with you in an attempt to work out a plan by which these drafts could be handled with minimum risks to Federal Reserve Banks."

It is accordingly respectfully suggested that the question whether the privilege of issuing these drafts should be withdrawn, should be made a topic for discussion at the next Conference of Governors, and that a copy of this memorandum and attached papers be forwarded to the Governors of all Federal reserve banks for their information in advance of their next Conference. A letter for this purpose is attached hereto.

Respectfully,

(s) G. Howland Chase
G. Howland Chase,
Assistant Counsel.

FEDERAL RESERVE BOARD

X-102.

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

April 25, 1917.

Dear Sir:

Following the last conference with the Governors of the Federal reserve banks in Washington the Committee on Clearings of the Federal Reserve Board took up the matter of Federal Reserve Exchange and has worked out a plan which the Board has approved to become operative May 21. An explanation of the plan and sample forms, are enclosed herewith for your information and guidance.

The Federal reserve banks are requested to issue as soon as possible circulars to their member banks embodying the rules and recommendations which are applicable to them, it being unnecessary, of course, to inform member banks of such details as concern the Federal reserve banks only.

Respectfully,

Governor.

Enclosures.

F E D E R A L R E S E R V E D R A F T S .

There shall be two special forms of drafts on each Federal Reserve Bank which will be available for immediate credit at other Federal Reserve Banks.

The privilege of drawing these drafts shall be extended to all member banks complying with the regulations formulated by their Federal Reserve Banks.

The drawing of these drafts shall not interfere with member banks drawing the ordinary checks on their Federal Reserve Banks.

The special drafts provided for in this circular must be drawn on forms approved by the Federal Reserve Bank of which the drawing bank is a member. The forms are to be similar to the specimens enclosed herewith.

Any Federal Reserve Bank may, if in the judgment of its officers it becomes necessary, make a reasonable charge against member banks drawing these drafts for the purpose of effecting transfers of funds, such charge not to exceed the rate for transfers prevailing at the time the drafts are drawn.

All of these drafts shall be ~~immediately~~ charged to the drawing member bank's account on receipt of advice by the

drawee Federal Reserve Bank. Specimen forms of advice are enclosed with this circular.

The two kinds of drafts shall be known as "Federal Reserve Exchange" and "Federal Reserve Transfer" drafts.

FEDERAL RESERVE EXCHANGE DRAFT.

The "Federal Reserve Exchange" drafts shall be the draft drawn by a member bank upon its own Federal Reserve Bank and made receivable for immediate availability at par at any Federal Reserve Bank but actually payable only at the drawee Federal Reserve Bank.

They shall, for the present and until otherwise provided, be drawn for amounts not in excess of \$250.00.

The drawing bank shall be required to give advice by mail to its Federal Reserve Bank of the total amount of drafts drawn each day.

These drafts on a Federal Reserve Bank when received for immediate availability by another shall be listed in a special letter and forwarded to the drawee Federal Reserve Bank for credit.

If the total of the letter justifies there can be an advice by wire and entries made on the day the letter goes forward.

FEDERAL RESERVE TRANSFER DRAFT.

The "Federal Reserve Transfer" draft shall be the draft drawn by a member bank upon its own Federal Reserve Bank and made payable on advice of the drawee at any Federal Reserve Bank specified in the draft.

They shall, for the present, be drawn for amounts in excess of \$250.00.

The drawing bank shall be required to give advice by mail to its Federal Reserve Bank of the numbers, amounts and total made payable at each Federal Reserve Bank of drafts drawn each day. This advice shall be under an authorized signature and a duplicate shall be forwarded to the Federal Reserve Bank at which the drafts are made payable, the duplicate advice to contain the signature in ink of officers signing the drafts.

FEDERAL RESERVE TRANSFER DRAFT.
(Continued)

The drawee Federal Reserve Bank shall, upon receipt of advice from the drawing member bank, telegraph the Federal Reserve Bank at which the drafts were made payable, confirming the advice and authorizing a transfer of the aggregate amount from its regular account to an exchange account.

When sending a telegram the arrangement of the code words for name of bank, date of advice and aggregate amount shall be in the order given and shall be understood to mean; Federal Reserve Transfer Drafts drawn by _____ per their advice dated _____ the aggregate amount of which is not more than \$_____ are good. Charge our account and credit our exchange account with the total amount advised in this telegram. See specimen telegram enclosed with this circular.

For the purpose of simplifying telegrams it is suggested that each Federal Reserve Bank may make a code so that each of its member banks can be designated by one code word, the first letter of the word to indicate the district in which the member bank is located.

The drafts when paid, by the Federal Reserve Bank specified in the draft, shall be marked paid, listed in a special letter and forwarded to the drawee Federal Reserve Bank. The total of the letter shall be charged to the exchange account of the addressee.

Under existing regulations governing the Gold Settlement Fund any Federal Reserve Bank can, at any time, obtain a settlement on a net balance due from another Federal Reserve Bank.

This plan shall become operative on the 21st day of May,
1917.

Enclosures:

FIRST NATIONAL BANK

Waco, Texas _____

To Federal Reserve Bank
of Dallas.

Gentlemen:

We have this day drawn checks on Federal Reserve Exchange
form, the total amount of which is \$ _____
_____ Dollars.

Charge our account to cover.

R. P. DUPREE,

Cashier.

X-95.

FIRST NATIONAL BANK

Waco, Texas _____

To Federal Reserve Bank
of Dallas.

Gentlemen:

We have this day drawn checks on Federal Reserve Exchange
form, the total amount of which is \$ _____
_____ Dollars.

Charge our account to cover.

R. P. DUPREE,

Cashier.

TELEGRAM FORM

April 12, 1917.

To Federal Reserve Bank,

Chicago, Ill.

Keramic Eclipse Animal Kronic Export Cursedly Slingcart.

Federal Reserve Bank of Dallas.

Decoded - Federal reserve transfer drafts	First N.B., Waco, Tex.	Amer.N. B.
drawn by		Beaumont, Tex.
per their advice dated	April 10th	April 11th
the aggregate amount of which		
is not more than	\$15,000.00	\$5,000.00

are good. Charge our account \$20,000.00 and credit our exchange account.

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

August 12, 1918.

X-1121

Dear Sir:

At the suggestion and upon invitation of the Federal Reserve Bank of Cleveland, an informal meeting was held on August 7th, at the office of the Federal Reserve Board to discuss Federal Reserve Exchange drafts. The meeting was attended by representatives of six Federal Reserve Banks. The recommendations made, a copy of which is inclosed with this letter, have been considered and approved by the Board.

(1) Federal Reserve Exchange Drafts.

Effective September 3rd, the limit of drawings of such drafts shall be increased from \$250 to \$5,000. Federal Reserve Banks paying Exchange drafts of other Federal Reserve Banks, will be permitted to deduct the amount paid from the total credits reported in the Gold Settlement clearing for the day. The daily transcript, forwarded to each Federal Reserve Bank, should show the items credited for the day and a deduction therefrom of the Exchange drafts paid for its account. The net credit should agree with the figures reported in the Gold Settlement clearings.

(2) The Board deems it desirable for the Reserve Banks to adopt the recommendation of the Committee, that all Reserve Banks give immediate credit for Clearing House items on the day such items are received from other Federal Reserve Banks, the balances so credited to be included in the credit balances reported for settlement through the Gold Fund clearings. The actual payment for such balances would then be made on the same day as settlement is received by the paying Federal Reserve Bank for the checks and other items it collects.

(3) With respect to the recommendation that a more detailed analysis be made of the 'float' situation (i. e., the extent to which immediate credit has been given upon uncollected items) there is inclosed herewith a memorandum prepared by the Statistical Division based upon the information which it has at hand. The Board is willing to have a more detailed study of this question made, but to do so will require a call for the necessary data from each Federal Reserve Bank and it is believed that such study could best be made at the different Federal Reserve Banks.

Very truly yours,

Governor.

Inclosures.

C O P Y

Washington, August 7, 1918.

Federal Reserve Board,
Washington, D. C.

Gentlemen:

At a meeting held in the Treasury Department Building in the Board Room of the Federal Reserve Board, August 7, 1918, at which the following were present:

- Mr. M. J. Fleming, Asst. Cashier, Federal Reserve Bank, Cleveland.
- Mr. S. H. Hendricks, Cashier, Federal Reserve Bank, New York.
- Mr. Pierre Jay, Federal Reserve Agent, New York.
- Mr. F. J. Carr, Asst. Cashier, Federal Reserve Bank, Chicago.
- Mr. Chas. A. Peple, Deputy Governor, Federal Reserve Bank, Richmond.
- Mr. Thos. Gamon, jr., Asst. Cashier, Federal Reserve Bank, Philadelphia.
- Mr. C. C. Bullen, Cashier, Federal Reserve Bank, Boston.

It is recommended to the Federal Reserve Board that the limit for the drawings of Federal Reserve exchange drafts be increased from \$250 to \$5,000 and that Federal Reserve Banks holding Federal Reserve exchange drafts of other Federal Reserve Banks be permitted to deduct such Federal Reserve exchange drafts from the total credits reported to the Federal Reserve Board in the Gold Settlement Fund each day.

In order to bring about a daily settlement for clearing house items, it is recommended that all Federal Reserve Banks give immediate credit for clearing house items the day received from other Federal Reserve Banks, without regard to the time of day received, inasmuch as the balance so created is reported to the Gold Settlement Fund at the close of business but is really settled the following day when the checks have been collected.

It is voted that the Federal Reserve Board be asked to cause a more detailed analysis of the "float" situation in each Federal Reserve Bank to be made, for such period as the Board may deem advisable, in order that there may be a more exact knowledge as to what constitutes a large amount of "float" now appearing in the statement of the Federal Reserve system and in order that each Federal Reserve Bank may study in a more detailed way methods of eliminating its own "float".

Respectfully,

M. J. FLEMING.

Chairman.

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-4362

June 19, 1925.

SUBJECT: Increasing Limit Federal Reserve Exchange Draft.

Dear Sir:

The Federal Reserve Board has approved the action of the recent Governors' conference in voting to raise the limit on the Federal reserve exchange draft from \$5,000 to \$50,000. This privilege afforded to member banks becomes effective August 1, 1925.

The reserve banks are expected to exercise care in checking up the permits extended to member banks to draw exchange drafts before passing credit on any such draft and to make telegraphic inquiry in any questionable case. The Board understands that whenever a Federal reserve bank withdraws a permit it will immediately advise all other Federal reserve banks.

Very truly yours,

Vice Governor.

To Governors of all F.R. Banks

FEDERAL RESERVE BANK OF SAN FRANCISCO

December 2, 1932

Copy of letter to all Federal Reserve Banks

It has occurred to us that many perplexing problems might arise in connection with exchange and transfer drafts in the event of suspension of the bank issuing these drafts before such drafts were presented for payment.

Thinking this problem may have arisen in your district, or that you had given some thought to what action you would take, we are listing a number of questions which have occurred to us and would appreciate your comments thereon.

I. In the event of insolvency of a member bank in its own district,

1. Would a Federal reserve bank have any obligation to pay the holder in due course of such a draft, if presented to it after the suspension of the member bank?

2. Assuming it might refuse to pay the draft so presented, would it have the right to reverse its entries and credit back the amount of the draft to the reserve account?

3. If the answer to 2 is in the affirmative, would it then have the right to apply such funds against any existing indebtedness of the member bank to the reserve bank, or would it be necessary to repay the funds to the receiver?

II. What would be the position of the two respective Federal reserve banks should one reserve bank pay a transfer draft after suspension of an issuing bank in another district,

1. If the paying reserve bank had not received telegraphic advice from the district in which the draft was issued of the suspension of the bank?

2. If such telegraphic advice had been sent but had been overlooked by the paying department of the Federal reserve bank in question?

(In connection with this question, the form of transfer draft provided would seem to clearly indicate that the bank of the district in which it is issued is the drawee, although it states that the draft will be paid by another specified bank.)

Copy of letter to all Federal Reserve Banks

-2-

III. What would be the position of the two respective Federal reserve banks should one reserve bank give credit for an exchange draft after suspension of an issuing bank in another district,

1. If it had not received telegraphic advice of suspension of the drawing bank?

2. If such telegraphic advice had been sent but had been overlooked by the paying department of the Federal reserve bank in question?

(With reference to both II and III, it should be borne in mind that a Federal reserve bank might pay out funds against credit given to its member bank before such draft or notice of its payment had reached the Federal reserve bank of the district in which it was issued.)

Some of these questions present two sides, namely, the proper action which should be taken by a Federal reserve bank of the district in which the drawing bank is located, and the action which should be taken by a reserve bank of another district should such items be presented to it for payment or credit.

We are writing to all of the Federal reserve banks in this respect as it is our feeling that the usefulness or service of these instruments to our member banks is quite problematical, and a reconsideration at this time might lead to the conclusion that it would be advisable to discontinue these facilities.

Yours very truly,

(Signed) W. M. Hale

C A S H I E R.

FEDERAL RESERVE BANK OF NEW YORK

C
O
P
Y

December 9, 1932.

Mr. W. M. Hale,
Cashier, Federal Reserve Bank of San Francisco,
San Francisco, California.

Dear Mr. Hale:

We are in receipt of your letter of December 2, regarding the paying of exchange and transfer drafts in the case of suspended banks.

In this district we have only two banks which are authorized to use transfer drafts and three banks which are authorized to use exchange drafts. We have, therefore, not been very much concerned regarding the problems which you bring up in connection with these drafts. It would appear to us that little risk is involved if instructions governing the issuance and paying of exchange and transfer drafts are followed.

When a member bank issues a transfer draft it sends to both its Federal Reserve bank and also to the Federal Reserve bank on which the draft is drawn, an advice covering such draft. Upon receipt of such advice from one of our member banks we immediately charge their account and credit Transfer Draft Account. After such an entry has been made we believe that we are obligated to pay the draft even though the drawee bank has suspended.

Exchange drafts are accepted by any Federal Reserve bank for collection and immediate availability at par. If any exchange draft is not collected for any reason, it would be charged back to the endorsing bank in the same manner as any other cash item. However, as we also receive an advice from our member bank when they draw an exchange draft,

Mr. W. M. Hale, Cashier

-2-

December 9, 1932.

an entry is immediately made upon receipt of advice, and we believe we are obligated to pay such draft after the entry is made even though it is presented to us after the bank has suspended.

Inasmuch as only a few banks in our district use exchange and transfer drafts to a very limited extent, it would be no hardship to discontinue such drafts in this district.

Very truly yours,

(Signed) J. M. Rice

J. M. Rice,
Assistant Deputy Governor,

FEDERAL RESERVE BANK OF PHILADELPHIA
925 Chestnut Street

C
O
P
Y
260

December 13, 1932.

Mr. William M. Hale, Cashier,
Federal Reserve Bank of San Francisco,
San Francisco, California.

Dear Mr. Hale:

This will acknowledge receipt of your letter of December 2nd, and we are answering your questions seriatim:

- I. (1) A Federal reserve bank would be obliged, at least morally, to pay the holder in due course of an exchange draft if presented to it after suspension of the member bank, if the advice of the member bank had been received and the funds set aside for that purpose, prior to receipt of suspension notice.
- (2) If the reserve bank could refuse to pay the draft so presented, it undoubtedly would have the right to reverse its entries and credit back the amount to the reserve account.
- (3) In our opinion if such entries were reversed a Federal reserve bank undoubtedly would have the right to apply such funds against any existing indebtedness of the member bank, as such reversal would simply be a restoration of the account to its original condition.
- II. (1) The responsibility of the paying reserve bank would not be governed by the question of whether it had received telegraphic advice of the suspension of the drawing bank, but would depend rather upon the question of whether or not the paying bank had received telegraphic instructions from the reserve bank in the district of the drawing member to pay the draft. Payment without such instructions places full responsibility upon the paying bank.
- (2) See #1.
- III. (1) It would seem that no question should arise covering this point, as exchange drafts are acceptable at par subject to final payment. If telegraphic or other advice of suspension to the reserve bank in the district of the member had not been received, the debit in the account certainly would be good and would provide funds to pay the draft. If no debit had been made the draft would be dishonored in ordinary course.
- (2) It is our opinion that if telegraphic advice had been received, but

Mr. Wm. M. Hale, Cashier
FRBank of San Francisco.

-2-

12/13/32

overlooked by the paying department, there would be no obligation to pay the exchange draft presented and responsibility would attach only if the paying bank had made an actual payment from funds derived through a debit made to the reserve account after notice of suspension had been received even though overlooked.

In our opinion the whole situation is governed by the following major points:

1. If the drawing member's Federal reserve bank has received notice that drafts have been drawn, either on exchange or transfer form, and has acted upon that advice to the extent of setting aside the funds prior to receipt of notice of suspension, then such drafts should be honored. Under any other circumstances such drafts should be returned.
2. A Federal reserve bank of another district should not pay a transfer draft without specific instructions to do so from the reserve bank in the district of the drawing bank. Under any other circumstances it makes payment at its own risk.
3. A Federal reserve bank allowing immediate credit for an exchange draft originating in another district assumes no risk in so doing, unless it permits withdrawal of the credit by an irresponsible endorser. If the exchange draft is dishonored at the paying reserve bank, the endorsing reserve bank certainly has the right to return it to its depositor.

I believe your suggestion is a good one - the reconsideration of this service and the practicability of its elimination without embarrassment to the member banks.

Very truly yours,

(Signed) C. A. McIlhenny

C. A. McIlhenny,
Cashier.

X-7454-e

C

O

P

Y

FEDERAL RESERVE BANK OF RICHMOND

January 9, 1933

Mr. W. M. Hale, Cashier,
Federal Reserve Bank of San Francisco,
San Francisco, Cal.

Dear Mr. Hale:

When your letter of December 2, 1932, raising several questions with reference to Federal reserve exchange and transfer drafts, was received I asked our counsel, Mr. Wallace, for his opinion, inasmuch as the problems involved seemed to be primarily legal rather than operating.

Mr. Wallace was quite busy at the time and did not submit his opinion until December 20th. I was away from the bank the last ten days of December and this is the first opportunity I have had to read the opinion and reply to your letter.

A copy of Mr. Wallace's opinion is enclosed herewith, and if the opinion holds - and I can see no reason why it will not - it does not seem to me that it will be necessary for the Federal reserve banks to alter their present practices. I will be very glad to have your opinion regarding the subject and would also like to know the results of your inquiries addressed to the other Federal reserve banks.

Yours very truly,

(Signed) J. S. Walden, Jr.

J. S. Walden, Jr.,
Controller

JSW:N

December 20, 1932

Mr. J. S. Walden, Jr., Controller Federal Reserve Exchange Drafts and
M. G. Wallace, Counsel. Federal Reserve Transfer Drafts.

-2-

for the protection and payment of drafts drawn by the former on the Banca Commerciale Italiana. A draft was drawn under the arrangement and delivered to a holder. Knauth, Nachod, and Kuhne were advised of the drawing of the draft and in turn advised their Italian correspondent, which debited Knauth, Nachod, and Kuhne, and credited the amount of the draft to a special account termed "drafts payable." The draft was presented, but in the meantime Knauth, Nachod, and Kuhne had been adjudicated bankrupts. The Italian bank therefore dishonored the draft and the Trinidad bank, having been compelled to take it up, claimed that the funds of Knauth, Nachod, and Kuhne on deposit with the Italian bank, which had upon receipt of the advice of the drawing of the draft been deducted from the general account and credited to a special account were impressed with a trust in favor of the holder of the draft, or else had been assigned and transferred to it. The Circuit Court of Appeals sustained the claim of the First National Bank of Trinidad, but the case was taken to the Supreme Court of the United States and the decision reversed, Justice Stone and Justice McReynolds dissenting. In the opinion of the court by Mr. Justice Holmes much stress is laid upon the fact that neither the purchaser of the draft nor the First National Bank of Trinidad were parties to or knew of the arrangement between Knauth, Nachod, and Kuhne and the Italian bank, and that there was no arrangement that any particular fund should be set aside but the method of bookkeeping between the New York bankers and the Italian bank was adopted purely as a matter of convenience, and that it had been the practice of the Italian bank to cancel such advices whenever requested to do so without inquiry as to who was the holder of the drafts or what had become of them. The fact that this case was decided in the Circuit Court of Appeals in one way and reversed by the Supreme Court of the United States by a divided court is of itself sufficient to indicate that there is some uncertainty in all such cases and that the case at bar represents a border line case.

Applying the principles of the above cases to our Circular No. 142 relating to the issuance of Federal Reserve Exchange drafts, I am inclined to the opinion that Federal Reserve Exchange drafts issued under the circular are clearly assignments of the fund against which they are drawn, or rather that the advice of drawing which the drawer bank must give is sufficient to constitute an assignment when read in connection with the circular, for in that case it is plain that the drawer of the draft is placed upon notice that when the draft is drawn and the advice given, its account will be charged. The circular states that Federal Reserve drafts are entirely different from ordinary drafts and are intended to serve a different purpose. The circular indicates that this difference is because ordinary drafts drawn on Federal reserve banks are payable only on presentation, and consequently will not be received by

December 20, 1932

Mr. J. S. Walden, Jr., Controller Federal Reserve Exchange Drafts and
M. G. Wallace, Counsel. Federal Reserve Transfer Drafts.

-3-

other Federal reserve banks for immediate credit, but that the Federal Reserve Exchange drafts will be received for immediate credit at par by any other Federal reserve bank or branch subject, of course, to final payment by the Federal reserve bank on which they are drawn. It is further provided that these drafts may only be drawn by banks which have theretofore obtained permission. This seems to imply that the Federal reserve bank will exercise some degree of responsibility in the matter other than that of a mere drawee, and this responsibility appears to be defined under the heading "Advices of Drafts Drawn," in which it is said, "The total of the amount of this advice will be charged to the reserve account of the member bank upon receipt and credited to a special account for the payment of such drafts when presented." It seems to me, therefore, that in authorizing the issuance of these drafts the Federal reserve bank has definitely undertaken that upon receipt of a proper advice the amount of the draft will be credited to a special account and held for the payment of such drafts when presented, which of necessity means held for the account of the holder of the draft rather than for the account of the drawer. While I believe that the circular implies that a Federal reserve bank, of course, would not be obliged to charge the amount of the draft to the credit of the drawer bank unless it had funds sufficient to support the charge, nevertheless, if such funds were available, it would be obliged to fulfill its contract and charge the account of the drawer bank and hold the funds in a special account for the special purpose of paying the draft when presented, which would of necessity mean hold the funds as due and payable to the lawful holder of the draft whoever he might be.

Applying this principle to the questions in the first section of Mr. Hale's letter, it appears to me:

(1) That a Federal reserve bank would be obliged to pay the amount held for the payment of the draft in question to the lawful holder of the draft regardless of anything that had occurred after the Federal reserve bank had charged the drawer of the draft with the funds and credited them to the especial account.

(2) If I am mistaken in the above conclusion and the funds should not be paid to the holder of the draft, I think it clear that then the funds would be transferred to the general account of the drawer and disposed of accordingly.

(3) If the funds were not payable to the holder of the draft, they would constitute a mere general debt to the original drawer, and would, of course, be subject to all rights of offset as any

X-7454-f

December 20, 1932

Mr. J. S. Walden, Jr., Controller. Federal Reserve Exchange Drafts and
M. G. Wallace, Counsel. Federal Reserve Transfer Drafts.

-4-

other indebtedness. In other words, it appears to me that no theory could be adopted under which such funds were not either payable to the holder or payable to the drawer. It could never be said that a special trust had arisen, but that that trust was for the use and benefit of the drawer of the draft and not for the holder of it.

Answering the questions in Section II. I wish to say that I am not very familiar with the use of Federal Reserve Transfer drafts, but I understand that such drafts, like Federal Reserve Exchange drafts, are issued only under a general authority from a Federal reserve bank of a district and are payable by another specified Federal reserve bank, and that it is usual for the Federal reserve bank of the district in which the draft is issued to wire an advice to the Federal reserve bank by which the draft is payable.

The questions might in some degree be affected by the forms of advice used. However, assuming that the advice is a definite instruction to pay the draft for the account of the Federal reserve bank of the issuing district, my answers to the questions in Section II. would be:

(1) If the paying Federal reserve bank had not received telegraphic advice from the district in which the draft was issued of the suspension of the drawee bank, then the paying reserve bank should pay the draft, and having paid it, could charge it to the account of the reserve bank in the district of issue, because the paying bank would in so doing act on the express instruction of the Federal reserve bank in the district of issue, which instruction had not been countermanded. The position of the reserve bank in the district of issue would depend upon what instructions it had received and what it had done. If it had been instructed to set aside funds and had done so, it could, I think, apply these funds to the payment of the draft, even though the drawer bank had subsequently suspended.

(2) If the advice of suspension had been received, but overlooked by the paying reserve bank, its position would be the same as if it had been received, but had been wilfully ignored. For the reasons given above, I do not think that a more general advice of suspension should be treated by the paying Federal reserve bank as a stop-payment order on such drafts; but, if the paying Federal reserve bank should receive express directions from the reserve bank in the district of issue to stop payment

December 20, 1932

Mr. J. S. Waldon, Jr., Controller. Federal Reserve Exchange Drafts and
M. G. Wallace, Counsel. Federal Reserve Transfer Drafts.

-5-

of the draft, the order should be obeyed; and if the paying Federal reserve bank failed to obey the order, whether because it was overlooked or for some other reason, it would be responsible to the Federal reserve bank of the district of issue for the consequences. The rights of the holder in such cases would of course depend upon the circumstances under which the draft was issued and what advice the drawee bank had given the Federal reserve bank of its own district and what had been done upon this advice.

My answers to the questions propounded in Section III., which, of course, are predicated on the assumption that I am correct in my view that Federal Reserve Exchange drafts constitute complete assignments and transfers if advice of the drawing has been properly given and acted upon, are:

(1) It does not appear to me that receipt of telegraphic advice by a Federal reserve bank other than the one on which the Federal Reserve Exchange draft is drawn is material. If the Federal reserve bank on which the Federal Reserve Exchange draft was drawn had received the advice of drawing and made a transfer before receiving the advice of suspension, the funds would be held for the credit of the holder of the draft regardless of whether that holder was another Federal reserve bank or some other person and the holder's knowledge of the completion of the assignment would not be material; but inasmuch as the Federal reserve bank in the other district would probably not know whether an advice of the drawing had been given or not, and if given, whether or not the drawing bank had funds sufficient to permit the draft to be charged to its account and the amount transferred to the especial account, it seems to me that a Federal reserve bank in another district should from motives of prudence avoid paying out any funds if it knew that the drawer bank had suspended, for since such drafts are subject to final payment, there would always be a possibility that when presented to the Federal reserve bank on which drawn, they would be refused because either the advice of the drawing had not been given properly, or, if given, because the drawer bank had no funds available.

(2) In line with the opinion which I have expressed above the situation is the same in all cases, for advice by telegraph has been given and wilfully ignored. In other words, any person receiving notice and then overlooking it is in the same situation as if he had received it and deliberately ignored it.

X-7454-f

December 20, 1932

Mr. J. S. Walden, Jr., Controller. Federal Reserve Exchange Drafts and
M. G. Wallace, Counsel. Federal Reserve Transfer Drafts.

-6-

You will notice, of course, that all of my answers above are based upon the assumption that the contracts under which Federal Reserve Exchange drafts and Federal Reserve Transfer drafts are issued are such as to constitute them assignments of the funds against which they are drawn, provided due notice of the drawing is given to the Federal reserve bank in the district of issue, and a definite appropriation of the funds in the hands of that bank is made before the suspension of the drawing bank. I feel fairly confident that this construction would be placed on the drafts if the question should ever be litigated; but, as you will see from the cases to which I referred, it is almost impossible to express an unequivocal opinion. If the Federal reserve banks desired to avoid any possible doubt, then they should refuse payment of such drafts if they had received notice that the drawing bank had suspended, and unless the receiver of the drawing bank and the holder of the draft could agree as to their rights, the Federal reserve bank should file a bill of interpleader and pay into court the amount of the draft in order that the court might determine whether the money belonged to the receiver of the drawing bank or to the holder.

Very truly yours,

(Signed) M. G. Wallace

M. G. Wallace,
Counsel.

MGW R

C

O

P

Y

FEDERAL RESERVE BANK OF ATLANTA

Office of
Cashier

December 15, 1932

Mr. W. M. Hale, Cashier,
Federal Reserve Bank of San Francisco,
San Francisco, California.

Dear Mr. Hale:

This will acknowledge receipt of your favor of the 2nd instant presenting a number of perplexing problems which you believe may arise in connection with the use of exchange and transfer drafts in the event of suspension of the bank issuing such drafts before the drafts are presented for payment.

A very small number of banks of this district are now authorized to issue exchange drafts and none are authorized to issue transfer drafts.

Thus far, probably due to good fortune, we have not had to deal with any problems of the nature suggested in your letter, though we realize that situations might develop that would call for definite and probably quick handling of matters resulting from the issue of exchange drafts in the event of suspension of the member bank by which they were drawn.

Instead of undertaking to answer your letter myself, I submitted it to our counsel, Mr. Robert S. Parker, and he has favored me with an expression of his opinion concerning all the problems your letter presents. I am enclosing a copy of Mr. Parker's letter, and I agree with the opinions he has expressed.

Several years ago, just how long ago I do not recall, we discontinued the use of transfer drafts because we considered them entirely unnecessary in view of the fact that member banks are afforded ample facilities for the transfer of funds through the medium of our private wire system.

I am inclined to think that the use of exchange drafts should also be discontinued because as you state their usefulness is quite problematical, and I believe their use involves too many hazards and risks that more than offset whatever little service they may be to the very limited number of member banks of the entire Federal Reserve System which are using them.

After you have heard from ^{all} the Federal Reserve Banks, if you find it convenient to do so, please let me have a summary or brief synopsis of their views.

Yours very truly,

(Signed) M. W. Bell

M. W. Bell

COLQUITT, PARKER, TROUTMAN & ARKWRIGHT
Attorneys at Law
Suite 1607 William-Oliver Bldg.
ATLANTA

C O P Y

December 12, 1932.

Mr. M. W. Bell, Cashier,
Federal Reserve Bank of Atlanta,
Atlanta, Georgia.

Dear Mr. Bell:

At your request I have read the letter concerning Federal reserve exchange drafts which Mr. Hale, Cashier of the Federal Reserve Bank of San Francisco wrote you under date of December 2nd. In Mr. Hale's letter he also makes reference to "transfer drafts," but I understand from you that the use of such last mentioned drafts has been discontinued.

You have asked me to indicate the way in which, in my opinion, Mr. Hale's questions should be answered.

In my opinion the rights of the drawer, drawee, payee or other holder of an exchange draft would be determinable by reference to your Circular No. F-4, which sets out the terms and conditions under which such drafts may be issued.

It is contemplated that when one of these drafts is drawn by a bank to which permission so to do has been given, the drawer gives written advice to the Federal Reserve Bank upon a form supplied by the Reserve Bank. Immediately upon receipt of such advice, the reserve account of the drawer is charged with the amount of the draft and there is a corresponding credit to a special account, which is maintained for the payment of the draft upon presentation.

I am of the opinion that, to all intents and purposes, an exchange draft should be treated as the certified check on the Federal Reserve Bank, the "certification" being effective as of the time when the advice of the drawing has been received. If this analogy is correctly drawn, then the answers to Mr. Hale's questions should be, in my opinion, as follows:

I

1. In the event of the insolvency of a member bank, the Federal Reserve Bank of the District would rest under no obligation to pay the holder in due course of an exchange draft

X-7454-h

Mr. M. W. Bell - #2.

12-12-32.

if the same were presented to it after the suspension of the drawer unless it had, prior to the receipt of the notice of suspension, received advice that the draft had been drawn. If it had received advice of the drawing of the draft prior to notice of suspension, then I think that the draft, upon presentation, should be paid out of the special fund, even though presented after notice of suspension.

2. I am of the opinion that after you had credited the amount of a draft to the special account created "for the payment of drafts when presented," you could not thereafter reverse your entries and credit back the amount of the draft to the Reserve account of the drawer.

3. I think that the "special account" referred to in your Circular, which account is "earmarked" for the purpose of paying exchange drafts upon presentation, could not be applied to the payment of an indebtedness of the member bank to the Reserve Bank. It follows that the funds in this account could not be paid to the receiver but should be retained by the Reserve Bank for the purpose of paying the draft upon presentation.

II

This division of Mr. Hale's letter relates to transfer drafts, the use of which by member banks in this District has been discontinued. It may be, however, that some of the Federal Reserve Banks still permit their members to issue such drafts. I have made no particular study of the legal effect of transfer drafts but believe that the general principles discussed in subdivision "I" would be controlling, viz., if the drawee Federal Reserve Bank charged the amount of the draft to the account of the drawer prior to notice of suspension and credited the amount of the draft in a special account, then it should be paid despite the fact that the drawer might have closed prior to the actual presentation of the draft to the drawee. If there is any doubt about this proposition, such doubt would, in my opinion, be removed in any case where telegraphic advice had been given to the Federal Reserve Bank specified as the bank to make payment.

III

It follows from the above that, in my opinion, the placing of the amount of a transfer draft in the special account

Mr. M. W. Bell - #3.

12-12-32.

prior to receipt of notice of suspension of the drawer would render the drawee Federal Reserve Bank liable for the payment of the draft, although, if the Federal Reserve Bank designated as the bank to pay actually knew of the suspension of the drawer when it made payment, the situation might be changed.

SUMMARY.

As stated heretofore, if we can properly analogize one of these drafts, the amount of which has been charged to the account of the drawer, to a check which bears the certification of the Federal Reserve Bank, then, at least in so far as concerns exchange drafts, I feel reasonably sure that the answers set out above are correct. I am not so sure of my ground in the case of a transfer draft. Practically regarded, however, it seems to me that no Federal Reserve Bank would pay one of these drafts unless it had received telegraphic advice from the drawee Federal Reserve Bank. If, after receiving telegraphic advice, it paid the draft, I think that the drawee Reserve Bank should pay the same even though before presentation it had received advice that the drawer had suspended.

I might add that I do not think that that part of Regulation J which prohibits the making of charges to members' reserve accounts after advice of suspension, etc. would affect or control a situation in which the reserve account had actually been charged with the amount of a draft prior to notice of suspension even though the draft itself had not been presented for payment.

Trusting that the above will be of some service to you and Mr. Hale, I am

Sincerely yours,

Robt. S. Parker.

RSP/w.

FEDERAL RESERVE BANK OF CHICAGO
230 South LaSalle Street

C
O
P
Y

December 8, 1932

Mr. W. M. Hale, Cashier
Federal Reserve Bank of San Francisco
San Francisco, California

Dear Mr. Hale:

We have your letter of December 2, in which you make inquiry as to our views regarding the position of a Federal reserve bank in connection with exchange and transfer drafts issued by a member bank in the event of the member bank having suspended business previous to the payment of the drafts.

The conditions governing the issuance of Federal reserve exchange drafts and Federal reserve transfer drafts provide that the member bank issuing either form of draft send a special advice to its Federal reserve bank on the date such drafts are issued authorizing the Federal reserve bank to charge its reserve balance with the total amount of the advice, it being understood that the amount be set aside in a special account for the specific purpose of paying the drafts described in the advice if and when presented for payment. Accordingly, it is our opinion that such funds should not be applied for any other purpose. It is also our opinion that, in view of the funds in question having been so segregated, a Federal reserve bank would be obligated to pay a holder in due course of such a draft if and when presented to it for payment, although the member bank had suspended business previous to the presentment of the draft.

Our opinion as above expressed would likewise apply to inquiries in your second paragraph, as we do not believe that either the receipt of notice or failure to receive notice of the closing of the drawer bank by the paying Federal reserve bank would affect the position of the paying Federal reserve bank; that is, once the charge has been made by the drawee Federal reserve bank to the reserve account of the drawer member bank, it is our view that the segregation of the funds is for the specific purpose of putting drawee Federal reserve bank in funds to honor the draft described in the advice if and when the draft is presented for payment. Notice of suspension of the drawer member bank subsequently received would not change the rights of the parties.

If we understand your third question correctly, the foregoing conclusions apply to it. In view of the fact that the member

Mr. W. M. Hale
San Francisco

-2-

12-8-32

bank drawing an exchange draft may fail to notify the drawee Federal reserve bank to charge its account with such amount, obviously the same risk attaches to permitting withdrawal of a balance created by a credit representing a Federal reserve exchange draft on a reserve bank of another district as to any other item credited subject to final payment.

The necessity or usefulness of these forms of exchange has been discussed at length in our bank on many occasions, and, while there may be a few member banks in our district that derive a definite benefit from this service, it is very much a question in our mind as to whether or not they should not both be dispensed with, as our records indicate the majority of our member banks that make use of either of these forms of exchange do not understand the purpose for which they were intended; that is, that the ordinary draft on us would serve the purpose in most cases.

We shall appreciate it if you will let us know the results of your survey on this subject.

Very truly yours,

(Signed) J. H. Dillard

J. H. Dillard,
Deputy Governor

C

X-7454-j

FEDERAL RESERVE BANK OF ST. LOUIS

C
O
P
Y

December 9, 1932.

Mr. W. M. Hale, Cashier,
Federal Reserve Bank,
San Francisco, California.

Dear Mr. Hale:

We have your letter of December 2. We discontinued the facility of "Federal Reserve transfer" drafts in August of 1918 for the reason that in June of that year the inauguration of free telegraphic transfers, in our judgment, terminated any need for the transfer drafts. This facility has not since been extended to our member banks.

Prior to the receipt of your letter we informally discussed the questions raised and it was our feeling that if an exchange draft was presented after the insolvency of the member bank drawing it that we would decline payment awaiting authority of proper jurisdiction. It was always felt that the balance provided for the payment of such drafts was a fund created for a specific purpose and could not be credited back to the reserve account nor be used to offset indebtedness of the insolvent member bank.

Since receipt of your letter the matter has been presented to our Counsel for his consideration and a copy of his opinion in respect thereto is enclosed.

Yours very truly,

(Signed) O. M. Attebery,

O. M. Attebery,
Deputy Governor.

X-7454-k

C

O

December 8, 1932.

P

Y

Memorandum for Mr. Attebery:

In considering the questions suggested by the Federal Reserve Bank of San Francisco, in letter of December 2, 1932, we will have to differentiate between the ordinary draft and the Federal Reserve exchange draft. In this to wit:

In the ordinary draft, the drawee, if he has received no notice of the insolvency of the drawer, honors or dishonors the draft as of the time it is presented and either pays in money or furnishes the payee with other exchange. In the latter case, the drawee becomes a debtor to the payee instead of to the drawer. The transaction, as between the drawer and the drawee, is complete as and from the moment the draft is presented.

Whereas, when the Federal Reserve exchange drafts are used, the drawer, simultaneously with the issuing of the draft, notifies the drawee that such a draft has been issued in favor of the named payee, and upon receipt by the Federal Reserve Bank of the advice of the issuance of such drafts, the Federal Reserve Bank charges the amount against the reserve account of the drawer and credits the amount to a special account for the payment of the drafts when presented. The amount of the draft is withdrawn from the account of the drawer the moment the amount is credited to the special account and thereupon becomes the funds of the payee as and when the draft is actually presented. A transaction similar to one where the drawee bank issues its Cashier's check or certifies the original check.

(1) From the foregoing, it would follow that in the event of the insolvency of the drawer before the actual draft was presented, the answer to sub-section I of Paragraph (L) would be in the affirmative; for, its acts in charging the drawer's account had taken place before it received any notice of insolvency of the drawer, and the drawee bank thereby became a stakeholder of a certain fund to be turned over to the holder of the draft when presented.

(2) Answering the second sub-section of Paragraph (1), the drawee bank, after it had charged the draft to the account of the drawer and had placed the funds in a special account for the payment of the draft, would have no right to reverse its entries so long as the draft in question remained outstanding.

(3) Answering the 3rd sub-section of Paragraph (1), so long as the draft remained outstanding, the drawee - the Federal Reserve Bank - would not have the right to use the special fund to pay the indebtedness of the borrowing bank to the Reserve Bank. Neither could the special fund be applied to the payment of the indebtedness of the drawee bank to the Reserve bank. If later, the Receiver of the drawer bank should

-2-

become the holder in due course of the draft in question, and should present it for payment, - for, the funds paid on the draft would come into the hands of the Receiver after the drawer had failed and it would be like other funds coming into the hands of the Receiver from other sources, - the funds could not be applied to the payment of the indebtedness of the Trust to the Federal Reserve Bank, a creditor of the Trust.

I believe the foregoing answers the questions listed under sections II and III.

Very truly yours,

(Signed) Jas. G. McConkey,
General Counsel.

C O P Y

X-7454-1

C
O
P
Y

FEDERAL RESERVE BANK OF MINNEAPOLIS

December 28, 1932

Mr. W. M. Hale, Cashier,
Federal Reserve Bank,
San Francisco, California.

Dear Mr. Hale:

Upon receipt of your letter of December 2 addressed to Mr. Ziemer, the questions included therein were submitted to our counsel, who today gives answer thereto as per copy of letter herewith. We regret that your communication was not sooner answered.

You will observe from counsel's letter that we are not using "exchange" or "transfer" drafts; therefore specific answers to your questions are not made.

With the Compliments of the Season,

Very truly yours,

(Signed) Harry Yaeger

Harry Yaeger,
Deputy Governor.

HY:EO
Enc.

UELAND & UELAND
Attorneys & Counselors

800 Security Building
Minneapolis

December 28, 1932.

Mr. Harry Yaeger,
Deputy Governor.

Please pardon our delay in answering your memorandum dated December 6, 1932 with reference to the letter dated December 2, 1932 from Mr. Hale, cashier of the Federal Reserve Bank of San Francisco.

Your bank does not use the "exchange" or "transfer" draft of the type referred to in Mr. Hale's letter. We have not had an opportunity to examine forms of the draft referred to by Mr. Hale, nor are we advised of the form of notice given by a member bank to its respective Federal reserve bank when such a draft has been drawn. Accordingly, our opinion as to the rights and liabilities arising out of this practice is probably of little, if any, value.

However, as we understand the practice, a transfer draft of this type would probably be taken to constitute an equitable assignment, to the extent of the amount of the draft, of the member bank's reserve balance. When the member bank drawing the draft had notified its Federal reserve bank of that fact, then we are inclined to think the effect would be the same as if the member bank had given a partial assignment of its reserve balance and had notified its reserve bank of such assignment. In other words, after such notice, the reserve bank would have to hold the amount of the draft for the benefit of the owner thereof.

If our understanding is correct, the answer to the questions put in Mr. Hale's letter would be that the Reserve Bank cashing or giving credit for such a draft would be protected in all cases provided the drawee Reserve Bank had received notice of such drawing and at the time of such notice there were sufficient funds in the reserve account to pay the same.

The questions presented by Mr. Hale suggest that the practice under consideration is rather anomalous from the legal viewpoint and might result in litigation and possible loss to a Federal reserve bank.

UELAND & UELAND

By Sigurd Ueland

SU/MG

X-7454-n

C
O
P
Y

FEDERAL RESERVE BANK OF KANSAS CITY

December 10, 1932.

Mr. W. M. Hale,
Cashier, Federal Reserve Bank of San Francisco,
San Francisco, California.

Dear Mr. Hale:

This will reply to your letter of December 2, with reference to the perplexing problems which arise in connection with the use of exchange and transfer drafts, and while our experience has no doubt been somewhat similar to your own, we have had a very limited use of such facilities in this district and no actual experience under conditions set forth in your letter.

We offered our member banks these facilities in 1917 and 1918, and while a few banks availed themselves of such facilities for a time, they gradually discontinued until during the past five or six years we have had but one bank using such facilities, which bank discontinued their use about a year ago, and at this time we have no bank using them. In view of the fact that we have had so little practical experience in this respect, we hesitate to express opinions on the rather involved hypothetical questions stated in your letter and doubt if such opinions would be of value to you.

We note that you have taken this matter up with all Federal reserve banks and that it is your feeling that the usefulness of the instruments to member banks is quite problematical and a reconsideration at this time might lead to the conclusion that it would be advisable to discontinue such facilities. We heartily agree with this suggestion and as a matter of fact have not embodied such facilities in our general letters in recent years, and have rather discouraged their use when we have had specific inquiries with reference to such service.

Trusting that the information furnished will be of interest to you, and with kind personal regards, I am

Yours very truly,

(Signed) • J. W. Helm

J. W. Helm,
Deputy Governor and Cashier.

FEDERAL RESERVE BANK OF DALLAS

December 8, 1932

Mr. W. M. Hale, Cashier
Federal Reserve Bank
San Francisco, California

Dear Mr. Hale:

We have your letter of December 2, 1932, addressed to Mr. R. R. Gilbert, who is at present away from the bank on his vacation.

Before answering the specific inquiries in your letter we set forth below briefly the mechanical operations followed in this district in the issuance of exchange and transfer drafts, as well as the practice of other Federal Reserve Banks in handling such drafts presented to them for payment:

FEDERAL RESERVE EXCHANGE DRAFTS.

Certain specified banks in this district are authorized by us to issue Federal Reserve exchange drafts, this authority being given after full consideration by our committee as to the bank's financial condition. Periodically the condition of the banks having been given this authority is reviewed. The names of all banks in this district authorized by us to issue such drafts are furnished to each Federal Reserve Bank. On the date such drafts are issued by the member bank, the bank is supposed to give us detailed advice of the number and amount of the draft so issued. Upon receipt of this advice from a member bank we immediately charge its reserve account and set up a suspense account on our general ledger for the amount of such draft. WHEN THESE DRAFTS ARE PRESENTED TO OTHER FEDERAL RESERVE BANKS IMMEDIATE CREDIT IS GIVEN THEREFOR, BUT THE DRAFTS ARE HANDLED FOR COLLECTION IN THE ORDINARY WAY WITHOUT SPECIAL NOTICE.

FEDERAL RESERVE TRANSFER DRAFTS.

Member banks in this district are authorized to issue Federal Reserve transfer drafts after similar credit investigation of the member bank to whom such privilege is granted. Other Federal Reserve Banks are not advised of the banks in this district authorized to issue Federal Reserve transfer drafts. On the date such drafts are issued the member bank issuing same is supposed to give us detailed advice over the signature in ink of the officer signing said draft, showing the number, amount and the Federal Reserve Bank to which such draft is made payable. Immediately upon receipt of such advice we charge the reserve account of the member bank for the amount of the draft and credit such amount into a suspense account on our general ledger. Immediately upon presentation to any other Federal Reserve Bank of a Federal Reserve transfer draft we are

given advice by wire of the presentation of such item for payment, and in the event we have not theretofore set aside in the suspense account on our general ledger a sum sufficient to meet this draft we, of course, immediately so notify the Federal Reserve Bank to whom the draft has been presented for payment in time for that bank to reverse its credit.

GENERAL DISCUSSION

Apparently there is no agreement between Federal Reserve Banks as to their respective liabilities in connection with such drafts. Furthermore, in so far as our district is concerned, we do not have any regulation defining the rights and obligations of the member bank and Federal Reserve Bank with respect to these items. Our circular in connection with these items consists only of detailed instructions concerning the issuance of such items.

We think that uniform agreements defining the rights and liabilities as between Federal Reserve Banks and uniform circulars defining the rights and liabilities between Federal Reserve Banks and their member banks should certainly be worked out and put into force if the practice of permitting issuance of these drafts is to be continued.

Assuming that our member banks issuing such drafts gives us the notice which they are supposed to give, and assuming further that this notice is received and their reserve accounts are charged prior to the suspension of the member bank involved, we answer your questions as follows:

I. 1. Yes

2. We do not believe that the Federal Reserve Bank would have the right to refuse to pay the draft when presented, and therefore it would not have the right to reverse the entry.

3. The answer to this question is covered by the answer to I. 2.

II. 1. We do not think that the position of the paying Reserve Bank would be affected by the suspension of the issuing bank, provided the details of the plan had been carried into effect, for the reason that, in our opinion, if the details had been perfected the issuing bank had made an assignment of the funds against which the draft was drawn.

2. The answer to this question is covered in the answer to II. 1.

III. 1. If the mechanics of the plan had been carried fully into effect prior to the suspension of the issuing bank, we do not believe that the position of either Federal Reserve Bank would be affected.

Mr. Hale, San Francisco, Calif. - 3 -

III. 2. The answer to this question is covered by the answer to III. 1.

We believe that under existing law a bank may assign funds, provided it clearly evidences an intention to do so and that such funds having been assigned before a bank closed would not be affected by the closing of the bank. This, we think, is the case where the mechanics of the arrangement are fully carried out prior to suspension. However, the vice in the present practice, it seems to us, is in the fact that issuing banks might under given circumstances issue such drafts without notifying the Federal Reserve Bank of the district in which it is located, and thus no assignment would take place prior to suspension; and in that event serious questions would arise as to the rights of both the paying Federal Reserve Bank and the Federal Reserve Bank of the district in which the issuing bank was located.

There are quite a number of questions that immediately occur to one in considering this matter and it would not be practicable in a letter of this kind to attempt to discuss all of them. We do believe that the matter as now handled in the Federal Reserve System is susceptible to much improvement, and we should be glad to join with you in an attempt to work out a plan by which these drafts could be handled with minimum risks to Federal Reserve Banks.

Yours very truly,

(Signed) R. B. Coleman

R. B. Coleman
Deputy Governor

FEDERAL RESERVE BANK OF RICHMOND

February 14, 1933

Mr. Albert C. Agnew, Counsel,
Federal Reserve Bank of San Francisco,
San Francisco, Cal.

My dear Mr. Agnew:

I received your letter of February 2nd enclosing a copy of your letter of the same date to Mr. Wyatt. Of course, I appreciate highly the comments which you made on my opinion addressed to Mr. Walden. As I understand it, neither of us feel at all confident as to what would be the rights of the various parties in a case in which a bank upon which a Federal Reserve exchange draft was drawn had received notice of the issuance of the draft and had segregated a fund sufficient to pay it or had received notice but had not actually segregated a fund, and certainly it would be highly desirable to remove the doubt on this point if it is practicable.

The Managing Director of our Charlotte Branch was in town a few days ago and in a discussion with me brought up another aspect of Federal Reserve exchange drafts to which I had never given much consideration. In my letter to Mr. Walden I was thinking only of the position of the Federal reserve bank upon which the draft was drawn; probably I was unconsciously following a maxim which used to be much used by a lawyer in this city; that is to say, "I don't care what happens as long as it don't happen to me." Mr. Clements, Managing Director of our Charlotte Branch, however, asked me what I thought would be the position of the bona fide holder of such a draft if it appeared that the member bank which drew it had not notified the Federal reserve bank of the drawing of the draft or had notified the Federal reserve bank but had no available balance which could be charged when the advice was received. Of course, viewing this solely as a question of law, the answer seems fairly simple. The draft could not be treated as an assignment of funds in the hands of the Federal reserve bank because there were no funds to transfer. It could not be regarded as giving the holder a right of action against the Federal reserve bank because obviously the Federal reserve bank has no relation to the draft except that of drawee, and has never accepted or certified the draft. Mr. Clements called my attention, however, to the fact that the forms used bear in very conspicuous letters the words "Federal Reserve Exchange," and the positive statement that any Federal reserve bank or branch will receive this draft for immediate availability at par. The circular of the Federal Reserve Bank of Richmond, which is, I assume, substantially similar to that in use by other Federal reserve banks, expressly provides that the drafts will be received by other Federal reserve banks and their branches "subject, of course, to final payment by the Federal reserve bank upon which it is drawn." An experienced banker or a careful lawyer would immediately recognize that a draft may be receivable for immediate availability by any Federal reserve bank, but that the funds which are thus made available will be paid only conditionally and the payee of the draft or other person receiving the payment will be nevertheless bound as endorser of the draft to repay the funds if the draft is dishonored. Mr. Clements, however, pointed out with much force that a business man, and

Mr. Albert C. Agnew,
Federal Reserve Bank of San Francisco,
San Francisco, Cal.

- 2 -

February 14, 1933

probably many bankers, examining the draft and knowing that the privilege of drawing these drafts was granted to member banks only at the discretion of the Federal reserve bank of their district, would probably conclude that the Federal reserve bank upon which the draft was drawn had assumed some responsibility in the matter. The drawee Federal reserve bank could probably successfully demonstrate that its responsibility was conditioned entirely upon the receipt by it of due notice of the drawing of the draft and upon the existence of a balance to the credit of the drawer of the draft when the notice was received. The holder of the draft, however, who had taken it for value upon the assurance that the amount of it would be made immediately available to him at any Federal reserve bank or branch would probably feel that this condition as to the payment of the draft was rather unjust.

Mr. Clements put the matter to me somewhat in this way: Suppose that you were a broker in California and a man from South Carolina sent you a Federal Reserve exchange draft containing the positive statement that the amount of it would be made immediately available to you at par by the Federal Reserve Bank of San Francisco, and relying on this assurance you accepted the draft and placed it in your local bank, and when the proceeds became available to that bank, released securities or goods to the person who had given you the draft; and a week later you received a notice that the bank which drew the draft was insolvent and that the draft had been dishonored and was returned to you, and you were obliged to take it up as endorser, and when you consulted your attorney you discovered that the draft which you had taken on a form prepared by a Federal reserve bank purported to be issued with the consent and authority of a Federal reserve bank was no better than the check of an unknown individual, except for the fact that your bank could obtain immediate credit for it from a Federal reserve bank, when as a matter of fact you usually obtained immediate credit for checks of individuals which you deposited in your bank and did not know that banks could not obtain immediate credit on such checks from Federal reserve banks. In other words, the fact that many, if not most, banks give immediate credit to their customers for checks deposited with them, means that Federal Reserve exchange drafts differ from ordinary checks in the hands of individuals only in points to which the individual is usually indifferent; but the entire form of the draft is such as to suggest to the individual that it has a value which makes it much more safe and desirable than the check of an individual.

I was obliged to confess that if I were the business man which Mr. Clements mentioned, I should feel that the Federal Reserve System had at least given me good reason to expect that I would receive money for my draft, and had allowed its name in a way likely to mislead the ordinary business man.

While, as I say, in my former memorandum I did not give much consideration to the consequences which might follow from the use of these drafts by individuals, my view that the courts would probably treat them as assignments of any funds in the hands of the Federal reserve bank upon which they were drawn was largely based upon the conviction that the court would feel that the holder of a

Mr. Albert C. Agnew,
Federal Reserve Bank of San Francisco,
San Francisco, Cal.

X-7454-p

- 3 -

February 14, 1933

draft had at least some sort of claim, legal or equitable, against the Federal reserve bank, and would endeavor to give to the draft as much effect as could be given to it without violation of the plain language of the circular under which it was issued. It is, of course, entirely within the bounds of possibility that some court would go much further than either you or I expect and hold that inasmuch as the privilege of issuing these drafts was granted only to a selected few banks, the Federal reserve bank which authorized the issuance would be held estopped to deny that it had funds in its hands to meet the draft. Such a decision would, of course, be contrary to the plain language of the circular and would be against the line of decisions which hold that a bank cannot agree to pay drafts drawn on it by a customer regardless of whether or not that customer has funds on deposit; but, as we know, courts have sometimes carried the doctrine of estoppel to extremes when it appeared that it was necessary to do so to prevent a result that amounted to an imposture.

Another point along the same line has occurred to me, which is probably of considerable interest to you. The Federal reserve bank which gives immediate credit for one of these drafts may have the draft returned by the drawee Federal reserve bank after a lapse of several days, and may discover that the bank which deposited the draft has failed as well as the drawer. In such a case the Federal reserve bank which made the proceeds of the draft immediately available will be in the position of the business man which I mentioned above. Of course, the risk which the Federal reserve bank takes is identical with that which they take upon ordinary checks, the proceeds of which under the time schedules become available in the reserve account before actual returns are received; but the time element is likely to be much longer in the case of Federal Reserve exchange drafts than in the case of checks. I realize, however, that the situation of the Federal Reserve Bank of San Francisco and the fact that much of its business is done in the "great open spaces" render all elements of transit time much more important to you than to us and to the Eastern Federal reserve banks.

I have been considering your suggestion that the use of these drafts should be discontinued, and while I have not had an opportunity to discuss all phases of the situation with the executive officers of the bank, I myself have come to the conclusion that the whole subject is so full of doubtful questions, both of law and policy, that it would certainly be advisable either to discontinue the use of the drafts, or at least to review the situation carefully and endeavor to eliminate some of the weak spots in the system as it operates at present.

I believe that the use of these drafts was originally instituted before the system of wire transfers had been introduced, or certainly before that system had been elaborated to its present extent, and I am strongly inclined to the opinion that the circular was drawn in a time when there was a tendency to assume almost as an axiom that a draft drawn by a bank which was a member of the Federal Reserve System, and certainly one drawn by a member of the System which had received permission from its Federal reserve bank to use the drafts, could be accepted with little or no doubt that it would be paid; and, therefore, the object of the System was

Mr. Albert C. Agnew,
Federal Reserve Bank of San Francisco,
San Francisco, Cal.

-4-

February 14, 1933

merely to give availability to a draft which was regarded as certainly ultimately collectible. Unfortunately, present conditions no longer justify the major premise upon which the system of Federal Reserve exchange drafts was, I believe, based

The operating officers of the bank tell me that these drafts are not used to any large extent by our member banks. In transfers from one bank to another it is more convenient to use the wire transfer. I understand that the drafts are largely used when some individual wishes to purchase from a country bank exchange payable at some point at which the bank has no correspondent. Therefore, as Mr. Clements pointed out, it seems that the chief use of the drafts at present is in the very class of transactions in which their use is likely to mislead the public, and it is far from improbable that they may do more harm than good when used under present conditions.

You understand, of course, that I have not discussed this matter with the senior officers of the bank and consequently what I have said is merely an expression of my individual views; but I am very positive that from the standpoint of a lawyer, if the use of these drafts is continued the circulars under which they are issued and the forms of the drafts should be carefully reviewed in the light of the experience which we have had in the past few years. One of the operating officers of the bank suggested to me that if no other revision was made, the form of the draft should at least be revised to the extent of changing the phraseology which indicates that any Federal reserve bank will receive this draft for immediate availability at par and the following words added: "Subject nevertheless to payment by the Federal reserve bank upon which it is drawn."

In your letter to Mr. Wyatt you suggest the advisability of taking up with the Federal Reserve Board the question of authorizing Federal reserve banks to discontinue the use of exchange and transfer drafts. Since each Federal reserve bank at present has power to withdraw the privilege of issuing Federal Reserve exchange drafts from any member bank, it would seem that each Federal reserve bank could at present discontinue the use of drafts drawn on it merely by revoking the privilege of drawing from any and all of its members. One Federal reserve bank could not discontinue the practice of giving immediate availability to drafts drawn on another Federal reserve bank without seriously disturbing the conditions in the district in which the drawee Federal reserve bank was located, and it seems to me the Federal reserve banks are in more danger of loss from drafts drawn on other Federal reserve banks than they are from the use of drafts drawn on themselves. It therefore occurs to me that a consideration of this matter by the Governors, and perhaps by the Committee on Collections would be appropriate, and after such consideration it might be possible to recommend to the Board that the entire system be discontinued by all Federal reserve banks, or else that such modifications in it might be made as to eliminate some of the difficulties which are now apparent.

I am sending a copy of this letter to Mr. Wyatt, as I know he will be

X-7454-p

Mr. Albert C. Agnew,
Federal Reserve Bank of San Francisco,
San Francisco, Cal.

-5-

February 14, 1933.

interested in the subject; and I think that you have earned the thanks of the System by bringing up for discussion a point which very obviously needs careful review and reconsideration.

Very truly yours,

M. G. Wallace,
Counsel.

MGW R