



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

S-49
Reg. A-2

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

November 23, 1937

SUBJECT: Discount of Consumers' Paper
by Federal Reserve Banks.

Dear Sir:

For your information there is inclosed herewith a copy of a letter which the Board has addressed to the First Vice President of the Federal Reserve Bank of San Francisco with regard to the question whether a note given directly to a member bank, the proceeds of which are used by the maker of the note to purchase goods for use and not for resale, is eligible for discount by a Federal Reserve bank under Regulation A.

A ruling incorporating the substance of the inclosed letter will be published in the December number of the Federal Reserve Bulletin, and Federal Reserve banks may advise member banks of the Board's position in this matter immediately if they so desire.

Very truly yours,

Chester Morrill

Chester Morrill,
Secretary.

Inclosure.

TO PRESIDENTS OF ALL FEDERAL RESERVE BANKS

November 23, 1937.

Mr. Ira Clerk, First Vice President,
Federal Reserve Bank of San Francisco,
San Francisco, California.

Dear Mr. Clerk:

This refers to your telegram of October 1, 1937, and our reply of October 2, 1937, and to our later correspondence with regard to the question whether a note given directly to a member bank, the proceeds of which are used by the maker of the note to purchase goods for use and not for resale, is eligible for discount by a Federal Reserve bank under Regulation A. In this connection it should be noted that the regulation permits paper, the proceeds of which are advanced or loaned to some other borrower, to be discounted provided the proceeds are used by such other borrower for a commercial, agricultural or industrial purpose, and provided the paper is of proper maturity and meets the other requirements of the regulation. If, therefore, the purchase of goods for use and not for resale is regarded as a commercial transaction, the note of a finance company, the proceeds of which have been or are to be used to finance the purchase of goods by consumers, may be eligible for discount.

Section 13 of the Federal Reserve Act authorizes a Federal Reserve bank, under certain conditions, to discount "notes, drafts and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Board of Governors of the Federal Reserve System to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act."

It is the opinion of the Board that a borrowing for the purpose of making a purchase of goods is a borrowing for a commercial purpose, whether the borrower intends to use the goods himself or to resell them. A note of a buyer given to a seller in payment for articles purchased is clearly a note issued or drawn for a commercial purpose. However, the purpose of the note is the same, whether given by the buyer to the seller or given by the buyer directly to a bank or finance company, for in either case the proceeds are used to finance a sale-- a "commercial transaction". While it may be suggested that from a practical viewpoint there is a difference between the discount of such a note in the hands of the seller and a direct lending by a bank or finance company to the purchaser, there appears to be no justification for any such distinction from a legal standpoint. In either

case the purpose of the giving of the note is to finance the final step in the distribution of goods, the sale to the consumer.

Accordingly, upon consideration of the question which has been presented, the Board has reached the conclusion that a note, the proceeds of which are used by the maker to purchase goods for use or consumption rather than for resale is a note arising out of an actual commercial transaction within the meaning of section 13 of the Federal Reserve Act. Accordingly, such a note given by the maker directly to a member bank will be eligible for discount by a Federal Reserve bank under Regulation A if it meets the applicable requirements of the regulation as to maturity and in other respects. For example, a note given to a member bank by a householder who uses the proceeds to purchase household equipment such as radios or furniture will be eligible for discount if it has a maturity at the time of discount of not exceeding 90 days. Likewise, the note of a finance company given to a member bank, the proceeds of which are loaned to other borrowers who use the funds thus obtained to purchase goods for use or consumption, will be eligible for discount by a Federal Reserve bank if the note meets the applicable requirements of the regulation as to maturity and in other respects.

Very truly yours,

(Signed) Chester Morrill

Chester Morrill,
Secretary.