FEB 15 1933

C.

Confidential

Memorandum Re: Proposed Plan for the Issuance of Secured or Unsecured Bank Scrip to Meet Withdrawals of Deposits During Periods of Banking Emergencies.

In view of the emergencies now facing banks in certain localities, the question has arisen as to the feasibility of the adoption by such banks of a plan for the issuance and circulation during the period of emergency of some form of secured or unsecured bank scrip with which to meet withdrawals of deposits in lieu of the payments of currency or transfers of credits which would normally represent such withdrawals--and the relationship of such a plan to the collection system of the Federal Reserve Banks.

At various times prior to the establishment of the Federal Reserve System, it became necessary for groups of banks to issue clearing house certificates or clearing house loan certificates, and for individual banks to issue scrip in some form, but in every such instance the necessity for issuing such instruments was not due to a lack of assets on which to obtain credit, but solely to a shortage of circulating currency. See article by A. Piatt Andrew on "Substitutes for Cash in the Panic of 1907" in The Quarterly Journal of Economics, issue of August, 1908, and "Clearing House Loan Certificates", Chapters X, XI, pp. 75, 117, Vol. 6, Publications of National Monetary Commission.

Since the Federal Reserve Banks came into existence no shortage of currency has existed, and, therefore, the situation today is in no sense analagous to any past experience. In the panics prior to 1915, banks permitted the free withdrawal or transfer of deposits for the establishment of credit, but were not in the position to pay deposits in cash; whereas today certain banks are not in the condition to permit the free withdrawal or transfer of deposits. Whether deposits be withdrawn in cash or for the establishment of credit is immaterial, since there is no shortage of currency but in certain instances a shortage in acceptable assets on which to obtain funds with which to meet continued withdrawals.

It is no doubt true that if banks in a certain locality, individually or as a group, are in a position to issue scrip based on adequate security they should be able to obtain advances from other banks, the Federal reserve banks (under the Glass-Steagall Act) or the Reconstruction Finance Corporation, but if such advances are obtained and depositors are permitted to continue withdrawals in cash or by transfer of credit, deposits may be depleted; and if it is essential for such banks to retain their deposits in some form or other, the issuance of scrip would make it possible for the banks to "freeze" their deposit liabilities during the period of emergency, provided they dc not make any payments except in the adopted form of scrip. Banks issuing scrip should agree or resolve to refuse to pay any deposits in cash or by transfer, but should pay or transfer deposits only by means of scrip. This is imperative in order that one depositor may not be preferred over another.

If, in the present emergency, it is deemed imperative or desirable to resort to the use of some form of bank scrip to meet withdrawals of deposits, such scrip may be issued under one of the following plans:

(1) By the clearing house or other appropriate organization representing all banks in a community under an arrangement in which every bank in that community would agree to participate, such scrip to be fully and adequately secured by the deposit with a trustee of unquestionably sound collateral.

Such scrip will probably circulate and take the place of currency within the community of issue as a medium of exchange for commodities or services provided the full cooperation of the banks and public of the community is obtained and the true value of such scrip is established and maintained. It is not probable, however, that such scrip will circulate as currency or be acceptable to creditors outside the community or trade area of the issuing banks except at a discount.

(2) By one or more but not all of the banks in a community, such scrip to be fully and adequately secured by unquestionably sound collateral as under plan (1).

Such scrip will doubtless circulate as described under plan (1) but to a lesser extent and at a greater discount. There is danger under this plan that any bank in the community which does not issue scrip will be drawn upon to provide currency which will have an appreciated value and also because of the admitted weak condition of other banks in the community which issue scrip.

(3) By all the banks in a community as under plan (1) except that the scrip issued will not be secured by collateral but guaranteed by all the banks in the community collectively.

Such scrip will be of doubtful value and while the necessity for some medium of exchange in the community may compel its circulation it will doubtless be accepted at a discount in the community and would not be acceptable at all outside of the community of issue.

(4) By one or more but not all of the banks in a community as under plan (2) except that the scrip will not be secured by collateral or guaranteed by other than the bank of issue.

Such scrip would be of doubtful and problematical value and would not circulate or serve as a medium of exchange even in the community of issue except at a heavy discount.

It should be borne in mind that under any plan the issuance of scrip is simply a device for bridging an emergency and that ultimately such scrip must be redeemed at face value or restored as deposits subject to withdrawal in normal course.

Regarding the handling by Federal Reserve Banks of items drawn against deposits in banks which have adopted the use of scrip, since Federal Reserve Banks cannot receive for collection and credit to the reserve accounts of member banks any items which are not collectible in cash, checks drawn against deposits in banks which are payable in scrip could not be handled by Federal Reserve Banks either as cash items or as non-cash items if received for collection and credit to the reserve accounts of member banks.

Checks on which it is indicated that they are payable only in scrip or with respect to which the payees have specifically agreed to accept scrip in payment may be received by Federal Reserve Banks from member banks as non-cash items for collection and remittance of the specific scrip to the indorsing member banks.

Checks which are known to be payable in scrip, but which do not indicate on their face or by indorsement that they are payable in scrip, should not be sent to Federal Reserve Banks for collection, since such checks could be handled by Federal Reserve Banks only as cash items and since they are not payable in cash they would ultimately be returned to indorsers unpaid.

Of course, Federal Reserve Banks could not accept for collection the scrip of any bank, since the scrip itself is not collectible in cash or anything else. If and when the banks are ready to redeem their scrip in cash, such scrip may be received by Federal Reserve Banks for collection.

Member banks issuing scrip should, of course, be required to maintain with Federal Reserve Banks their required reserves against their net deposits including outstanding scrip. The reserve balance of a member bank is, of course, not subject to check or transfer except by the member bank and therefore cannot be depleted by any other means.