Developments in the organization and functions of American banks since the establishment of the Federal Reserve System

Mary Ellen Donovan

State University of Iowa

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DEVELOPMENTS IN THE ORGANIZATION AND FUNCTIONS OF AMERICAN BANKS SINCE THE ESTABLISHMENT OF THE FEDERAL RESERVE SYSTEM

A Thesis

submitted to the Faculty of the Graduate College of the State University of Iowa

in partial fulfillment of the requirements for the degree of Master of Arts

by

Mary Ellen Donovan

Iowa City, Iowa

June, 1921
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INTRODUCTION

The Nature of Commercial Banking

The first chapter of this study attempts to make clear the nature of commercial banking. The balance sheet of an individual bank is used as an aid in exposition. Among the items appearing on the balance sheet, Surplus especially seems to stand in need of explanation. A surplus is commonly thought of as a sum of money, a fund set aside by the bank. It is important that it be made clear that a surplus is dollars worth, not dollars, that it simply indicates that the shareholders have an equity in each of the resource items.

Bank Credit

The current theory of bank credit, namely, that manifold loans are extended by a given bank on the basis of a deposited accretion to its reserves is erroneous, and it will be shown that this theory is the result of failure to distinguish between the loans of individual
banks and those of the banking system.

Is Banking Parasitic?

The statement is sometimes made that banking is parasitic. This assertion is based upon the fact that a bank is able to make loans equal to several times its reserves, but the point is overlooked that while it is true that to the extent that bankers make manifold loans and deposits on the basis of a given amount of cash, prices tend to go up, the result is that the purchasing power of the dollar is reduced, and while the banker receives more interest, his purchasing power is not increased. In reality, his real income is reduced through the operations of the banking system.

Liquidity of Bank Assets

Our consideration of the liquidity— or non-liquidity— of bank assets must be confined to the period before the establishment of the Federal Reserve System for at the present time the liquidity of the assets of any individual bank is, in the main, a matter of eligibility for rediscount. While in normal times bank assets possess a high degree of liquidity due to the fact that they can be
shifted from one bank to another, experience has shown that in times of stress, none of them are liquid in the sense that they can be quickly converted into cash.

The Effects of the New Powers Conferred Upon National Banks by the Federal Reserve Act

The developments in commercial banking have been going on silently, and the indications are that we are today approaching a point of development where the department store is very distinctly suggested. The Federal Reserve Act by granting to National banks authority to exercise trust company powers, to accept savings deposits and to lend on farm land and other real estate has placed National banks in a position to actively compete with State banks and trust companies in sundry lines of business which have always ranked as the most profitable carried on by State institutions. The tendency today is for each bank to offer a complete banking service. Our banking system prior to the passage of the Federal Reserve Act may be compared to that which prevails in England in division of work and specialization. The system in vogue today is similar to that of Germany where the credit banks com-
bine all kinds of financial business (generally with the sole exception of mortgage credit transactions) so that every customer can settle all his financial affairs in one spot on comparatively the cheapest terms possible.

Bank Service

The idea of bank service is growing by leaps and bounds, and the progressive banks of today have officers whose chief duty it is to find out how the bank may offer additional service.

The Federal Reserve Check Collection System

The banking system of the United States has been greatly strengthened by the establishment of the Federal Reserve Check Collection System. This system has served as a solution of the exchange problem, as a remedy for the circuitous routing of checks which had resulted in the pyramiding of reserves, and as a means of correcting the generally unsatisfactory conditions which had prevailed for many years in this branch of banking. The operation of the check collection system at the present time comes from a comparatively small number of banks seeking to protect their own profits and is largely the result of failure to comprehend the advantages to be gained from a universal collection system.
The operations of a commercial bank may be best understood by a consideration of the balance sheet, tracing the various items entering into such a report from the beginning of business through the operations of banking.

We may suppose that a bank opens with a capital of $100,000, all of which has been paid in cash, and a surplus of $10,000, also contributed by shareholders, and that has invested in a banking house $20,000. The initial statement at the opening of business would be as follows:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash $90,000</td>
<td>Capital $100,000</td>
</tr>
<tr>
<td>Banking House 20,000</td>
<td>Surplus 10,000</td>
</tr>
<tr>
<td>$110,000</td>
<td>$110,000</td>
</tr>
</tbody>
</table>

The bank now begins its dealings with the public, and we will suppose that shareholders and other depositors immediately leave with the bank $90,000 in cash. The statement will then stand:

| Cash $180,000    | Capital $100,000 |
| Banking House 20,000 | Surplus 10,000   |
| Deposits $90,000 | $200,000        |

| $200,000        | $200,000        |
The bank receives and approves applications for loans amounting to $65,000, $15,000 of which is taken in cash and the balance in deposit credit. The statement will then read:

<table>
<thead>
<tr>
<th>Loans &amp; Discounts</th>
<th>$65,000</th>
<th>Capital</th>
<th>$100,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking House</td>
<td>20,000</td>
<td>Surplus</td>
<td>10,000</td>
</tr>
<tr>
<td>Cash</td>
<td>165,000</td>
<td>Deposits</td>
<td>140,000</td>
</tr>
<tr>
<td></td>
<td>$250,000</td>
<td></td>
<td>$250,000</td>
</tr>
</tbody>
</table>

The bank decides to establish connections with two banks in financial centers and places with these banks $40,000 on deposit. This transaction will make the following change in the statement:

<table>
<thead>
<tr>
<th>Loans &amp; Discounts</th>
<th>$65,000</th>
<th>Capital</th>
<th>$100,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Due from Banks</td>
<td>40,000</td>
<td>Surplus</td>
<td>10,000</td>
</tr>
<tr>
<td>Banking House</td>
<td>20,000</td>
<td>Deposits</td>
<td>140,000</td>
</tr>
<tr>
<td>Cash</td>
<td>125,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>$250,000</td>
<td></td>
<td>$250,000</td>
</tr>
</tbody>
</table>

An application for a mortgage loan of $10,000 is approved, the entire amount of which is taken in cash.

The statement will then read:
The directors decide that the amount of cash on hand is too large and decide to invest $40,000 in United States bonds. The statement will then stand:

<table>
<thead>
<tr>
<th>Loans &amp; Discounts</th>
<th>$75,000</th>
<th>Capital</th>
<th>$100,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Due from Banks</td>
<td>40,000</td>
<td>Surplus</td>
<td>10,000</td>
</tr>
<tr>
<td>Banking House</td>
<td>20,000</td>
<td>Deposits</td>
<td>140,000</td>
</tr>
<tr>
<td>Bonds</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>75,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>$250,000</td>
<td></td>
<td>$250,000</td>
</tr>
</tbody>
</table>

A customer requests a certificate of deposit for $9500, bearing 4% interest, in return for a like amount of checks on other banks. Without reproducing the bank statement, we will indicate the changes made by this transaction. Due from banks is increased $9500 and a new item, certificates of deposit appears among the liabilities.

The bank decides to issue $40,000 of notes and forwards to the United States Treasury a like amount of
bonds as security. In accordance with the National Bank Act, it must also maintain a 5% redemption fund. We may suppose that the notes are paid out to borrowers. Loans and discounts are increased $40,000, cash is decreased $2000, a new item, redemption fund, appears among the assets, and a new item, circulating notes, among the liabilities.

A customer draws a check in favor of a depositor of the bank for $75, overdrawing his account that amount. A new item, overdrafts, will appear among the assets, and deposits will be increased $75.

The bank receives additional deposits of $125,000, $50,000 in cash and $75,000 in checks on other banks. Cash is increased $50,000, due from banks is increased $75,000, and deposits are increased $125,000.

The bank discounts for a customer $26,000 of commercial paper, maturing in 60 days at 6%. The proceeds, $25,740, is left on deposit. Loans and discounts will be increased $26,000, deposits are increased $25,740, and a new item, undivided profits, in the amount of $260, appears among the liabilities.

Local merchants are granted loans totalling $70,000 on the deposit of suitable collateral and the amount is left on deposit. Loans and discounts are in-
creased $70,000 and deposits are increased $70,000.

The bank buys in the open market $60,000 of commercial paper; the time is four months; the rate 7%; the discount $1400, and pays for same by a New York draft for $58,600. Loans and discounts are increased $60,000, due from banks is decreased $58,600, and undivided profits is increased $1400.

Through the lapse of time, the bank accumulates profits in the amount of $100,000 which are currently invested in the regular assets of the business. This amount the directors designate as surplus. Although the earnings are invested currently, without being accumulated as a fund prior to their investment, we may conveniently suppose for the sake of exposition or analysis that this amount is accumulated as a cash balance and set aside as ear-marked funds. The condition of the bank would now be as follows:

<table>
<thead>
<tr>
<th>Loans &amp; Discounts</th>
<th>$271,000</th>
<th>Capital</th>
<th>$100,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overdrafts</td>
<td>75</td>
<td>Surplus</td>
<td>110,000</td>
</tr>
<tr>
<td>Due from Banks</td>
<td>65,900</td>
<td>Undiv. Profits</td>
<td>1,660</td>
</tr>
<tr>
<td>Banking House</td>
<td>20,000</td>
<td>Deposits</td>
<td>360,815</td>
</tr>
<tr>
<td>Bonds</td>
<td>40,000</td>
<td>CDs</td>
<td>9,500</td>
</tr>
<tr>
<td>Redemption Fund</td>
<td>2,000</td>
<td>Circulating Notes</td>
<td>40,000</td>
</tr>
</tbody>
</table>

$621,975 $621,975
In the above statement, "Loans and Discounts" and "Deposits" are disproportionately small for a going banking concern, and in order to become attuned to the system of which it is a part and to make a profitable record, it will be impelled to lend until it establishes a normal ratio of cash or reserve to deposits, the ratio being normally in the neighborhood of 10%, more or less.

Two items have appeared in our balance sheet which require further explanation, Undivided Profits and Surplus. Undivided Profits may be thought of as accumulating earnings; this account fluctuates with every transaction of the bank. From this account is deducted current expenses, dividends to stockholders and all losses. Like Surplus, Undivided Profits simply indicates that the shareholders have an equity in each of the items on the assets side of the balance sheet. Surplus is usually built up out of Undivided Profits. When the management of a bank sees fit, it instructs its bookkeeper to transfer a certain amount from Undivided Profits account to Surplus account.

Surplus represents the accumulated earnings of a bank. It generally stands as a clean, round sum and remains fixed over a period of time. There seems to be a general idea that Surplus is a sort of extra reserve fund. It is not a cash reserve; it is excess asset value due to
shareholders, not dollars, but dollars worth. Neither is it a fund so invested that the bank possessing it is in a position to secure on short notice an addition to its cash resources. There is no provision in the law for investing resources which arise from the creation of a surplus in exceptionally liquid assets, and, in practice such assets cannot be distinguished from any other assets. It is clear, then, that Surplus is important, not in connection with the immediate, but with the ultimate solvency of a bank. In this connection it is of great importance; the accumulation of a surplus increases a bank's assets, and the creditors have a larger margin of safety in the event of liquidation. A large surplus is an evidence of the growth of a bank and also of its strength and safety.

Bank Credit

The statement of a representative commercial bank within a given credit area shows loans equal to several times the cash holdings of the bank, and the same situation is found in banks taken in the aggregate. Theorists observing this have offered the explanation that if an individual bank thoroughly assimilated to the system has loans equal to ten times its reserves, the
acquisition of an additional primary deposit would enable it to make new loans equal to ten times the amount of such deposit. The contention that an individual bank in a system can make loans equal to ten times the amount of additional cash newly acquired is based on the assumption that the lending bank would lose no cash as the result of its loan operations, because checks drawn by borrowers against their loans would be offset by the checks of the customers of other banks which were also expanding their loans, and this assumption is the result of confusing the operations of an individual bank, which constitutes only one unit in the system, with the operations of the banking system as a whole.

If a representative American bank with an approximate ratio of 1 to 10 between cash and deposits were to attempt upon the securing of a new primary deposit of, say $10,000 to add $100,000 to its loans, the result would be a loss of cash through unfavorable clearing house balances. Money is borrowed to be used, and the borrowers

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1 A primary deposit is a deposit of cash or its equivalent which has no direct connection with a loan. A derivative deposit is one which owes its existence to a loan or which is built up in anticipation of the repayment of a loan.

of this bank would at once send checks to their creditors, many of them in distant cities. A comparatively small amount of the checks issued, perhaps $10,000, would be in favor of depositors of this bank. The typical ratio of derivative deposits to loans for American banks is, roughly, about 20%, so our bank would retain perhaps $10,000 represented by checks in favor of its depositors, plus 20% which borrowers would leave on deposit, or $20,000, and the remainder, $70,000, would be lost to banks scattered throughout the system. Such a transaction would obviously reduce the cash of our bank to the danger line. The contention that claims and counter-claims would still balance is clearly untrue because the addition to a bank's reserves ordinarily comes from other banks in the system, in which case the loans of those banks would contract rather than expand, or from imported or newly mined gold, which would ordinarily be received by a comparatively small number of the banks, and it is evident that the other banks would not increase their loans simply to prevent a loss of cash by the bank receiving the reserve.¹

How much, then, can our bank, which has a cash-deposits ratio of 10% and a derivative deposit-loan

¹ Op.cit., pp.75, 75
ratio of 20%, add to its loans on the basis of a new primary deposit of $10,000? It would be able to add to its loans to the amount of about $11,000 and would retain about $1220 in cash as a reserve against the $12,200 deposits, $10,000 primary deposits and $2220 derivative deposits which would be owned by the bank after the borrowers had checked against the proceeds of their loans. It is evident, then, that although the reserve retained, or the residual cash, forms the basis of loans and deposits many times greater than itself, the residual cash is only a small fraction of the newly acquired cash on the basis of which the banker expands his loans. It is only through the operations by which a bank receives a dollar, lends a dollar and keeps ten cents that it finally has loans equal to ten times the amount of its cash holdings.

If we think now of one bank doing the entire banking business of the country, it is clear that the acquisition of a new primary deposit of $10,000 would enable the bank to make loans equal to several times the amount of the new deposit. The loan expansion would be

1 Op.cit., p.67
limited only by the necessity of maintaining the normal cash-deposits ratio. If the cash deposits ratio is 1 to 10, the bank could lend $9000. This would be possible because the lending bank would lose no cash. All checks drawn by borrowers would be in favor of depositors of the bank.

It is evident that the erroneous theory that a representative individual bank in a system can make a manifold increase in its loans on the basis of a given addition to its reserves is the result of failure to distinguish sharply between the loans of individual banks and those of the banking system.

We have seen that a bank is able to make loans equal to several times its reserves, and the inference from this fact has sometimes been that banking is parasitic. The contention is that the banker receives a return of 6% on his cash holdings; that he has created manifold loans resulting in deposits which mean increased purchasing power and higher prices. It is true that to the extent that bankers make manifold loans and de-

posits on the basis of a given amount of cash prices tend to go up, but the result is that the purchasing power of the dollar is reduced, and while the banker receives more dollars in interest, his purchasing power is not increased. In reality, the real income of the banker is reduced through the operations of the banking system. Furthermore, the interest rate rises very slowly so that it does not offset the decline in the purchasing power of the principal caused by the rise in prices. During periods of high prices, the borrowers make much greater profits than the lenders, and as a result of their desire to seize their opportunity loans are rapidly expanded. As loans are expanded, prices continue to rise, and this goes on until the slow but progressive advance in the interest rate overtakes the rate of rise in prices. When this occurs, the conditions which precipitate a panic are usually present.

**Liquidity of Bank Assets.**

We may now turn to a consideration of the liquidity—or non-liquidity—of bank assets, and in doing so it will be necessary to confine the discussion to the period before the establishment of the Federal Reserve.
System, for at the present time the liquidity of the assets of any individual bank is, in the main, a matter of eligibility for rediscount. Before the passage of the Federal Reserve Act, the theory was quite universally held that commercial paper is automatically self-liquidating and that investment paper is inherently unliquid, and we must examine this theory as it worked out in actual practice before commercial paper was given liquidity through the privileges extended to it by the Federal Reserve Banks.

In practice, we find that the commercial loans made by a bank to its customers are not always liquidated promptly at maturity. Frequent renewals are granted by country banks, a loan often being extended for years. These renewals do not necessarily indicate that the loans are used for investment purposes, or that the paper is not good. They may indicate merely a continuous need for working capital. There is no doubt, however, that in the country many loans are used for non-commercial purposes.

In the commercial centers, the keen competition between banks and the need for continuous working capital in some lines, such as manufacturing, wholesaling and
retailing in staple lines, make the renewal of loans very common, if not the rule. It may be said that commercial banks furnish permanent working capital for concerns in staple lines. Very frequently these concerns never completely liquidate at any time with their banker. The extent to which bank credit serves for permanently financing industry has been underrated. The bulk of our banking credit is financing our industry rather than our commerce. The statistics of all commercial banks show that something like 50% of all loans is devoted to investment uses and that in the neighborhood of two-thirds of all credit extended by commercial banks goes for fixed rather than working capital. Although many commercial notes are paid at maturity, analysis shows that the commercial paper of a bank's own customers is among the least reliable of all its assets as a means of replenishing depleted reserves. A banker never knows, as long as he adheres to the policy of renewing loans at the pleasure of his customers just what percentage of the maturities at any given date will be paid.

Collateral loans are more reliable as bank assets than commercial loans to customers. If a
collateral loan is not paid at maturity, the banker may dispose of the collateral, although he may hesitate to do so through fear of losing a customer. It was estimated in 1909 that collateral loans constituted over 22% of total bank resources in the United States.

Loans made through commercial paper houses are extremely servicable as bank assets, due to the fact that renewals are never granted. The loans generally run for six months. In 1918, four billion dollars worth of this paper was held by commercial banks in the United States.

Bonds which are high-grade as to both security and marketability are very reliable bank assets and, in the main the bonds purchased by banks are of this character. For an individual bank they are highly liquid because in normal times they are easily shifted from one bank to another.

The item "Due from Other Banks" is a highly important factor making for liquidity as long as fair weather continues. In the financial and speculative centers to which these balances are sent there is at all
times an indefinitely large demand for loans, and a very considerable part of the funds received by banks in the money centers is loaned on stock exchange collateral, and so to a great extent supply the liquidity for bank assets and make possible local loans on non-liquid paper.

If we now turn from the individual bank to the banking system, we find that it unquestionably furnishes most lines of business with permanent working capital. Often a customer will liquidate with his own bank by selling his paper through brokers, so that there is no reduction in the total amount of credit extended by banks; it has simply been shifted from one bank to another.

So far, we have considered the liquidity of bank assets in normal times and found that so long as fair weather continues liquidity is a synonym for shiftability. But when trouble sets in, we find that almost none of them are liquid in the sense that they can be quickly converted into cash; they will not stand the test of ready negotiability. It is absolutely impossible for banks to collect any considerable part of loans made to customers. One authority states that it is to be questioned whether banks could find among their Loans &
Discounts item one-fourth of the total which they could refuse to renew. Furthermore, at such times there is always a greatly increased demand for accommodation.

Paper bought through note-brokers could be counted on in time of crisis only under the impossible condition that the banks holding it knew when the crisis would occur and could arrange maturities accordingly.

Collateral loans are not especially liquid in emergencies due to the fact that the market at such times is flooded with securities which renders it practically stagnant.

Bonds are practically analogous to collateral. The more people there are who want to sell bonds and the fewer who want to buy them, the lower their price will be and the less easy it will be to sell them at all. From the standpoint of the system as a whole, the relief that can be furnished by bonds is practically negligible.

Balances with other banks, which are considered as reserve have been found to be largely unavailable in times of strain. Each bank, acting singly, tries to strengthen its position by withdrawing its balances, thus shifting to the central money market.
virtually the entire responsibility of meeting the situation, which is certain to involve the banks in a general suspension of payments, as in the crisis of 1857, unless some measure of common action is adopted by the banks, as was the case in subsequent crises.

The unhappy consequences of the inability of banks to cope successfully with emergencies have been eliminated by the operations of the Federal Reserve Banks, which, through the ample reserves at their disposal, are now able to cope with any emergency which may arise.
NEW BUSINESS ACTIVITIES OF AMERICAN BANKS

The typical American bank of today may properly be called a financial service station. Service may be defined as the point of human contact between the bank and its depositors, or as anything which a bank does for or in behalf of its customers or the community. It is especially applicable to those things which a bank is not legally bound to do, but which it does to show its appreciation of its relationship and responsibility to its customers and to the community in which it is located.

There was a time when bankers thought that their chief duty was to their stockholders and not to their customers; they did not realize as they do today that the interest of the stockholders are not sacrificed but advanced by giving the depositors chief consideration. The attitude of the old-time bankers toward the public was too much that of frozen dignity. Practically the only advertising they thought it wise to do was to insert in small space their statements as required by law. Many of the older banks secluded their officers; the policy today is to keep them in view where they are available
We have reason to believe that the days of cold-storage banking are past, and the day of kindly human interest in the customer is dawning.

Mr. Edward H. Kittridge, Manager of the publicity department of the Old Colony Trust Company of Boston, a speaker at the recent convention of the Financial Advertisers Association, said—"The banker of today surrounds himself with the atmosphere of cordiality. He makes a decided effort to meet his customers freely and sympathetically, and tries to make them feel that they are as important to the bank as the bank is to them. In other words, he humanizes his institution and tries in every way to establish a personal contact with his clientele, and realizes that business is not the test, but "service", whereby he and his institution are measured".

A member of the staff of the National City Bank of New York who has much to do with the various phases of the bank's service to clients and friends makes the following statement:

"The term "Service" is very much overworked and is so intangible that a definition is difficult. Our idea of service to our clients is to place at their dis-
posal every modern banking facility, and, in addition, to look after their interests here in the same manner we would like them to attend to our business if our positions were reversed. Daily we receive requests for information of all kinds, many of them foreign to the banking business, and we are called upon to perform many services which are not in any sense banking functions, and we make every effort to handle these requests in a manner which will be satisfactory to our clients. We have bought books, checked trunks, referred business propositions to reputable individuals in the city, and our representatives have appeared before various departments in Washington in the interests of our clients. Yesterday, we met a Greek family on an incoming ship, took them to a railroad station and arranged for their transportation to an inland city. These illustrations are indicative of the wide scope of our service. In addition to these, a very important feature at this time is our foreign trade service, by means of which we compile information from all parts of the world regarding markets, prices and trade conditions, and distribute it to customers in the country who are interested in importing
and exporting merchandise. We also maintain an Industrial Service Department by means of which we provide those of our clients who desire it with expert industrial engineering advice and suggestions".

In this great bank and many of our largest banks new phases of service are discovered almost every day. Many of them have officers whose chief duty it is to find out how the bank may offer additional service. The great majority of bankers, however, do not yet realize all the various forms of service which their banks are capable of rendering. If they did, many of their advertising problems would be solved for they could then make this the basis upon which to lay the greatest stress in advertising.

There are three important requisites in the preparation for efficient service. First, the bank must be managed by men of character, ability and judgment. Second, in hiring employees who are to meet the public they must be careful to select men of ability and integrity. Third, the general groundwork must be laid among the employees for a knowledge of just what good service is and it must be made of vital interest to them.
to study it and to render it whenever called upon to do so.

Mr. George C. VanTuyl, President of the Metropolitan
Trust Company of New York City, has an article in the
Bankers Magazine for December, 1917, entitled "Making
Good on Service", in which he shows that he has gone to the
bottom of the matter and that he is convinced of the
necessity of beginning within the bank itself by render-
ing the study of service of interest to the employees and
making it profitable for them to pursue it. Recognizing
the need for a spirit of good fellowship among the em-
ployees, his bank established an employees' club, of
which practically all of the employees were members, and
which became so successful that the bank built a club
house in close proximity to the city, provided with all
the facilities for friendly enjoyment and healthful com-
petition. The bank also issued a monthly paper which
contained items of interest to employees, matters con-
nected with the growth of the institution, and which
gave prominence to clippings from various sources showing
the best instances of good service practiced by other
institutions, both industrial and banking. Mr. VanTuyl
said, "The spirit of the paper is service, the spirit behind it is service, the spirit that has promoted the club is service".

Almost every bank has some means of increasing the efficiency of its employees in order to render the best possible service to the public, and no bank can afford not to do it, for only after it has solved this problem is it in a position to talk about good service to the public.

The modern bank endeavors to offer a complete banking service, and the large banks have installed an increasingly large number of departments, each furnishing a specialized service. Many progressive banks, however, maintain commercial, savings and trust departments, and we may now consider some of the services which these departments offer.

**Commercial Department**

The commercial department of a bank serves the business man, who, in order to carry on his business needs current funds or credit. Therefore, the commercial department is constantly striving to
increase its deposits, thereby enlarging the bank's loaning capacity. While service is becoming increasingly necessary for the life and growth of all departments, it is of especial importance to the commercial department because its success depends on its ability to secure the accounts of business men, to assist them in their activities, and to aid the community by enabling the various industries to employ their deposits to the greatest possible advantage. The commercial depositor is, as a rule, familiar with the bank's ordinary services. To gain his special interest and attention, it is often necessary to offer him special services.

Auditing of Books for Business Establishments

Progressive commercial departments have recognized that merchants are demanding more accurate cost finding and offer first-class assistance to business men in auditing their books. Many of them make a practice of sending their auditors to business establishments, upon request, to make a complete audit of the books, for which they charge only a nominal fee. Many of these departments engage lecturers to give
series of talks to business men on the importance of better business methods. There is no attempt made by the lecturer to appeal directly for new business for the bank bearing the expense of the campaign, but the departments report that satisfactory results have been obtained.

Construction Loans

Since the Federal Reserve Act conferred upon National banks the authority to lend on real estate, commercial departments of our banks have done much toward solving the serious housing problems in this country. They have encouraged the building of new homes and aided in the economical financing of their construction, thereby discharging a civic responsibility resting upon our banks, and at the same time promoting their own interests.

A prominent Massachusetts bank has set aside a sum in excess of its capital and surplus, and, of course, many times what it could loan direct on real estate, for making construction loans, using the credit of responsible builders for the medium of such loans. The home-owner must have been a depositor and known
to the officers as responsible. When the house is completed, the National bank assists in securing a savings bank mortgage of long duration, and will then carry for the builder the balance which is reduced by the amount put up by the owner and which is also secured by second mortgage. The latter is reduced monthly and is a desirable bank investment in every way. This is an excellent plan as it brings the bank directly in touch with the home-owner, and is most satisfactory to all concerned.

The loan associations, home-building corporations and mortgage institutions, as well as the builders and contractors of New York State are all given substantial loans, at low interest rates, for the purpose of stimulating building.

The banks of a prominent town in New Jersey loan well managed building and loan associations up to five months of their receipts for dues. The amount so loaned is greatly in excess of what could be legally loaned on real estate direct.

Banking by Mail

Since people have come to realize the convenience of banking by mail, this offers an opportunity to the commercial department to extend to its customers a service which goes far toward holding old accounts and securing new ones. Commercial departments having a large number of farmer customers have an exceptional opportunity to make good on this point, but it is by no means allotted to the out-of-town customers alone, as many within the city find it a great convenience. Depositors may send checks for credit, and if the pass book is inclosed, it is returned to them promptly, together with envelopes and deposit tickets for further use; otherwise, a duplicate deposit ticket is forwarded. If customers' notes are due, and they wish to renew them, the bank forwards renewals, and on receipt of renewal notes and check for interest, cancels and mails the old notes. On request, the bank will issue its Cashier's checks in payment of bills. Any inquiries which customers make in regard to their business matters are promptly and courteously answered.

Income Tax Service

A service which at the present time is especially
appreciated by bank patrons is advice on the Income Tax Law. Firms or individuals affected by the Income Tax Law may obtain from progressive banks the forms which they are required to use and assistance in making the return.

Calf Clubs

As a result of a desire on the part of the banks to get farmers interested in pure-bred cattle, calf clubs have become quite popular with them during the last few years. In this State, the work has usually been done under the direction of an expert from the Agricultural College at Ames, who in many instances, is asked by the bank to select and buy the calves, which are then sold to the children of farmers at a reasonable price, the bank taking the note of the purchaser for one year, same being indorsed by the father or guardian of the child.

Clerking of Stock Sales

The clerking of stock sales by employees of commercial departments is a service which has done much toward strengthening the relations between the bank and the farmer. The man clerking the sale makes a report
to the farmer and then attends to the account of each purchaser until it is satisfactorily adjusted. The bank assumes the responsibility of securing credit reports on buyers who desire to give notes, thereby enabling the man selling to pass on them.

Returns on Stock Shipments

Another service which appeals to the farmer is in connection with returns on stock shipments. Many farmers arrange to have these returns sent to the bank. They are credited to the customer upon receipt and a duplicate deposit ticket mailed, or, in some cases, the party directs the bank to hold the funds and calls personally for them. The farmer feels that he receives better service by dealing through the bank than by dealing direct with the commission houses.

Since bankers have begun to realize that from 50% to 60% of all new business is the direct result of efficient service, one might recount almost endlessly devices used by commercial departments of modern banks to improve their service.
Savings Departments

The savings department of a bank exists primarily for the saver, the man of small means, but much can be done to make savings accounts immensely profitable both to the depositor and to the bank.

Honoring Checks on Savings Accounts

A service which many savings departments offer and which is much appreciated by the public is their willingness, in case of necessity, to honor checks on savings accounts. Many people who do not ordinarily need a checking account sometimes have occasion to issue a check on their savings account, and it is an accommodation to have it honored by the bank.

Thrift Talks to Children

Savings departments are also coming to realize the importance of reaching children by talking to them in the schools, asking the teachers to talk to them and issuing thrift booklets. Various methods are
devised for handling the accounts. Sometimes the teacher collects the money and account of it is kept on a card which is issued to the child until it reaches One dollar, when the bank issues a regular savings pass book. Although these accounts are often handled at a loss in the beginning, constant effort and publicity usually result in profitable returns.

Home Economics Bureaus

A number of savings departments make strong appeals for women's accounts by installing home economics bureaus. The major work of the bureau consists of interviews in the bank. Customers are invited to come as often as they desire for help in making adjustments in their spending and for general information on household management. When desired, blanks for a "Household Budget" or "Personal Expense Account" are given. The Bureau of Home Economics, Society for Savings, Cleveland, Ohio, reports that the budget leaflets, together with signs in the bank, newspaper advertising and publicity are the ways in which people first learned about the bureau, but at the present time about one-half of the
people who come are sent by friends whose the bureau has benefited.

Another important part of the work in connection with the Home Economics Bureau in a bank is the giving of talks to various groups, such as college students, librarians, factory employees, Y. W. C. A. clubs and women's clubs. An effort is made to suit the talk to the particular audience.

The results accomplished by these bureaus are important. In the first place, they assist people to save who have never saved before. They teach their customers to increase their savings, in some cases to double them, although their incomes are not increased. They assist others to adjust their spending so that they obtain a better balanced living.

Services to Foreigners

The progressive savings departments, especially those of the large banks, are making special efforts to secure the accounts of foreigners. Many foreigners avoid the banks managed by American officers because
they do not understand their method of doing business, and, as a consequence, hide their money in secret places. To overcome the prejudices and fears of these people, the banks are sending out solicitors to work among them, to tell them of the bank's strength and safety. Tellers are employed who speak the language of the dominating classes of foreigners in the city, so that when the solicitor brings in a prospect, he can be introduced to a teller who speaks his own language. Factories and stores are solicited, literature is distributed, and the point is emphasized that the bank employs an interpreter who will be glad to explain the bank's service to them. Much valuable business is secured in this way. While there is not so great an opportunity for this kind of service in the small towns, the underlying principle may be applied. There are some foreigners in every community, and, like every one else, they are pleased when their business is appreciated and when helpful service is extended to them. During the war, the banks did much good work among foreigners. These people were often solicited to sell their bonds at a discount or exchange them for undesirable stocks or foreign currency, thus undermining the work of
the thrift campaigns that floated the four loans. Many banks recognized their opportunity and advertised that since great numbers of people who held Liberty Bonds had no safe place to keep them, they had decided to store the bonds in their vaults free of charge. They also stated that they would collect the coupons without expense to the owner and would deposit them to his credit in a savings account which would itself draw interest. They made it clear that no money had to be deposited, that they merely credited the coupons to a savings account which would be open for the bond-holder when the first coupon came due. This offer drew to the bank many people who would never otherwise enter its doors and paved the way for future accounts.

Trust Department

Beside their fiduciary capacity, modern progressive trust departments are putting into operation plans for increasing their services and thus creating new business and increasing their earnings.
Affiliated Institutional Department

Several large trust departments are rendering real service and securing profitable business through the creation of an affiliated institutional department. The time of this department is given to managing the affairs of clubs, including such organizations as welfare leagues, patriotic associations, the boy scouts, country clubs, and so forth, the department acting as secretary, treasurer, or agent and usually assuming the entire financial management of the organization; it also acts in an advisory capacity to the society. This service has a personal appeal to business men who formerly refused high positions in these organizations because of the office drudgery that went with them. The institutional department is ready to do the work for these men, under their direction; it has on its staff authorities on system, expert accountants, bookkeepers, and so forth. Every community has fraternal and social organizations which need guidance and assistance, and the institutional department performs a real public service.

The Community Trust

An opportunity which has been taken advantage
of by the trust departments of some of the large banks
is the creation of a "Community Trust", which is a public
trust established by persons who contribute to a fund,
the income from which is to be used in aiding charitable
and educational institutions which are not operated for
profit. This fund is of great service to the com-
munity; it aids the sick and aged, improves living con-
ditions and provides recreation. Small charities and
educational institutional are usually insufficiently
endowed; the Community Trust plan aids them whenever
practicable. Through this plan people of moderate
means are enabled to help in a great work. The trust is
flexible and elastic and capable of being apportioned
to meet the needs of the times. This service illustrates
the human side of the trust business.

Safety Deposit Service

Safety deposit service is an outstanding feature
of almost every trust department, and much is being
accomplished toward doing away with the old idea held
by the vast majority of people that a safety deposit
vault is a place for wealthy people to keep stocks and bonds. Most banks find that the best way of reaching safety deposit prospects is by direct advertising, and to be successful in an advertising campaign the bank must have some special feature, something worth while, special equipment, service, or whatever it may be, and then the advertisement must drive it home. Some banks give three or four months free rental on the first year's rental of a safety deposit box. The rent of a box which will meet the requirements of the average person is about one cent a day, at which cost no one can afford to risk the loss of their valuable papers, even if they have only insurance policies. These campaigns, in addition to securing new business for the bank, are of service to the community because they educate people to the importance of having adequate protection for valuable property.

Advertising

An increasingly large number of banks extend their activities through the use of pamphlets and similar material, and it may be in place to give a brief account of the nature of typical pieces of advertising
material of this particular character.

One class of pamphlets looks inward to the bank and its service and sets forth the strength, service or standing of the bank. A pamphlet entitled *Shawmut Service*, issued by The National Shawmut Bank of Boston illustrates this type. It was prepared with the object of acquainting depositors and others with some of the varied and highly helpful services which a modern, highly organized and progressive bank places at their disposal. The booklet extends an invitation to depositors and others to make full use of "Shawmut Service", and then proceeds to describe the services rendered by the various departments of the bank, namely, the commercial banking, credit, collection, coupon, safe-keeping, safe-deposit, transfer and trust departments. The booklet further states that customers may avail themselves of the advantages of introduction to the bank's correspondents in the cities for the purpose of establishing new connections, obtaining accurate local information on credit matters, or with regard to trade or other local conditions. Attention is also called to the services offered by the tax consultant of the bank. The pamphlet also extends an
invitation to customers to make use of the data compiled for their use concerning the operation of important laws dealing with commerce and finance and the benefit and convenience of bankers' acceptances in the financing of imports and exports.

Another class of pamphlets issued by banks looks at the great world of commerce outside and contains information of interest to customers regarding production and the development of the resources of the community. A pamphlet issued by The Denver National Bank, entitled Agricultural, Industrial and Mining Conditions, is representative of this type of advertising material.

While some of the services which we have considered belong within the province of the city bank and others pertain essentially to the field of country banking, the broad underlying principles are the same, and the important point is that every banker shall study the needs of his own community and shall feel that he has a definite duty to that community which can be performed only by giving the best service of which his bank is capable.
NEW POWERS CONFERRED BY THE FEDERAL RESERVE ACT UPON NATIONAL BANKS

Prior to the passage of the Federal Reserve Act, Congress had not in any sense kept pace with State Legislation in extending corporate banking powers, and the discrepancy between State banking and National banking had become a source of serious concern to those banks operating under National charters.

When section 9 was incorporated in the Federal Reserve Act, giving to State banks and trust companies all of the benefits of the Federal Reserve plan of cooperation, this discrepancy became even more serious since it took from National banks certain advantages which up to that time had served to offset in some measure the broader powers given to State banks and trust companies. State banks joining the Federal Reserve System may under section 9 of the Act obtain Federal Reserve notes and may rediscount commercial paper. They may also be designated as Government depositories by the Secretary of the Treasury and obtain practically all of the advantages of the System, except the privilege of issuing circulating notes based upon Government bonds, and this is largely offset by the privilege of obtaining Federal Reserve notes.

With these advantages added to those already
enjoyed by reason of the broader corporate powers of State banks and trust companies, it became imperative for Congress, in order to preserve the integrity of the National banking system and of the banks composing the system, to render the functions of National banks similar in a very high degree to those of State banks and trust companies. Accordingly, new powers were conferred upon National banks, based upon the principle that unification of the entire banking system was desirable and that such unification could be accomplished only by placing National banks in a position to compete with State banks and trust companies on more nearly equal terms. Under present conditions, National banks more nearly approach the status of departmental banks, which the Federal Reserve Act apparently contemplated.

**Trust Powers of National Banks**

Section 11(k) of the original Federal Reserve Act provided that, subject to the provisions of the Board, and when not in contravention of State laws, National banks might act as trustee, administrator, and registrar of stocks and bonds, under such rules and regulations as the Board provided.

Almost immediately after the adoption of the Federal Reserve Act, there was an urgent demand from
National banks for the establishment of regulations under which they could exercise trust company powers, but the Board did not deem it wise to act on this subject for some months after its organization. However, in July, 1915, it adopted the policy of authorizing National banks, otherwise qualified, to exercise the powers conferred by section 11(k), unless there was an express provision of the State law, either directly, or by necessary implication, prohibiting a National bank from exercising such powers.

The Board was disturbed by the opposition which its advocacy of an extension to National banks of some of the privileges enjoyed by State institutions aroused, particularly in New York and gave out the following statement:

"From recent articles and statements, it appears that the impression has been received in many quarters that when a National bank is permitted by the Federal Reserve Board to act as trustee, executor, or administrator, the exercise of these powers will result in serious conflict of jurisdiction as between the State courts and authorities and the Federal Government.

"It is somewhat difficult to understand upon what the ordinary assumption is based. It is assumed, both as a matter of law and as a matter of policy, that
National banks exercising the powers referred to will be subject to the State laws relating to the administration of trust estates, just as any other corporation which is permitted by State authority to exercise these powers.

"When such estates are administered under the jurisdiction of Courts, the National bank appointed by the Court, or named in the instrument creating the trust, will, of course, be subject to the orders and rules of such Courts, and there should not be any conflict of jurisdiction in so far as the administration of such estates is concerned.

"It is unfortunate that a mistaken impression of the purpose and effect of this provision of the Federal Reserve Act should result in creating a seeming issue for which no real basis exists."

The Board further states in its 1915 report:

"It is with regret that the Board reports that its action in granting fiduciary powers authorized by the Federal Reserve Act to National banks has been the subject of much criticism and opposition on the part of a number of trust companies who are engaged in the business of commercial banking in direct competition with National banks. Suits have been instituted in two or more States to test the constitutionality of section 11(k) and to prevent by injunction or otherwise the exercise of the power of
trustee, executor, administrator and registrar of stocks and bonds by National banks on the ground that the exercise of these powers is in contravention of the law of the State in which such National banks are located. Advices have been received that similar suits will be started in other States. The Board has authorized its Counsel to intervene in these cases, to file briefs in support of the constitutionality of the Act, and to appear and argue the questions involved when this course is deemed necessary or advisable. Every effort will be made to obtain an early adjustment of this important question by the Supreme Court of the United States."

On April 18, 1915, trust companies under the banking laws of New York presented a protest to the Federal Reserve Board, stating that the Federal Government had no power under the Constitution to permit a corporation to perform such functions. The Board declined to act upon the protest, except by resolving to continue the granting of permits to National banks under the authority of the Federal Reserve Act.

Finally, a suit was filed by the trust companies of Michigan to test the constitutionality of the grant of trustee functions to National banks. On November 4, 1916, the Supreme Court of Michigan declared that Congress had exceeded its constitutional powers in granting such
functions. An appeal was taken to the Supreme Court of the United States, and on June 11, 1917, that Court handed down its decision. The lower Court was reversed, and the Court sustained the constitutionality of section 11(k) of the Federal Reserve Act.

The decision in this case is of far-reaching and vital importance to the Federal Reserve System in that it not only sustains the right of Congress to vest in National banks the powers enumerated in section 11(k), but fully recognizes the right of Congress to grant to such banks any and all powers that are necessary to enable them to meet the competition of banks and trust companies operating under State charters.

During the year 1916, 125 applications for permission to exercise fiduciary powers under the terms of the Federal Reserve Act presented to the Board were granted, action on 84 of which carried approval of full fiduciary powers, while in the case of 41 only limited powers were granted.

Under the law as amended September 16, 1918, the fiduciary powers which may be granted to National banks were enlarged so as to include authority to act as guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies or other corporations which compete
with National banks are permitted to act under the laws of the State in which the National bank is located.

The Board is authorized to grant permits to National banks to exercise fiduciary powers in any case in which competing State corporations are permitted to exercise such powers, even though the laws of the State directly, or by necessary implication, prohibit the exercise of such powers by National banks.

The Federal Reserve Act goes no further than to permit to National banks the right to exercise fiduciary powers. The terms of their exercise and the regulations and restrictions regarding their exercise are matters of State legislation and administration. Article IX of the Regulations of the Board states that—"Nothing in these regulations shall be construed to give a National bank exercising the powers permitted under the provisions of section 11(k) of the Federal Reserve Act, as amended, any rights or privileges in contravention of the laws of the State in which the bank is located within the meaning of that Act". The Board reserves the right to revoke a permit if it is convinced that a bank has willfully violated either State or National laws pertaining to the exercise of fiduciary powers. It is plain that the intent of the Act is to place State institutions and National banks in the same
State upon an equal footing in the exercise of such powers.

The first step in the procedure for obtaining fiduciary powers by a National bank is to write to the Federal Reserve Board or any Federal Reserve Bank for a copy of application, form No. 61. The form makes a formal application for the exact powers desired, based upon a resolution of the Board of Directors and duly signed by the officers. In this form must be inserted the name and location of the applying bank, the population of the city or town in which it is located, a statement of assets and liabilities, and a certified copy of the resolution of the Board of Directors. The application, properly executed, is to be mailed to the Chairman of the Board of Directors of the Federal Reserve Bank of the District in which the applying bank is located, and is to be sent by him to the Federal Reserve Board. The Federal Reserve Agent, before transmitting the application, adds certain information in regard to the regulations as to financial institutions exercising fiduciary powers under the laws of the State in which the applying bank is located and such other information relative to the applying bank and its officers as he can give, together with his recommendations as to the granting or rejection of the application.

When the application is received by the Federal Reserve Board, it is first referred to the Counsel for
legal opinions and recommendations. It is then sent to a sub-committee which adds information which is based on reports of the National bank examiner, together with its recommendations. The application, with all of this information, is then sent to the Committee, from which it goes to the Board for final action.

The Agent of the Federal Reserve Bank of New York in his report to the Federal Reserve Board for 1919 makes the following statement in regard to the development of trust business by National banks:

"A number of the banks, especially those in the larger cities, are actively developing fiduciary business, but in the smaller places many of the banks have gone no further than to obtain the Board's permission to transact it.

The total number of National banks holding permits on December 31, 1920, was 1,321.

Savings Deposits

Another important innovation of the Federal Reserve Act was the provision for the acceptance by


National banks of time deposits on which they may pay interest. Under the National Bank Act, National banks were not specifically authorized to organize savings departments, but the competition for deposits and the payment by State banks and trust companies of higher rates of interest on savings accounts resulted in National banks establishing savings departments, or paying interest on savings accounts. As the law did not distinguish between savings accounts and demand deposits, National banks were compelled to carry the same reserve against one as against the other, and there was no certainty that the savings department rules could be enforced. However, nearly half of the National banks in the United States, prior to the passage of the Federal Reserve Act, had established savings departments and held more than Eight hundred million dollars of savings deposits. Under the liberal interpretation of the law by the Comptroller of the Currency this was permitted because it was not specifically forbidden.

The right to accept interest-bearing time deposits is expressly conferred on National banks by section 24 of the Federal Reserve Act, which provides that-

"Such banks may continue hereafter as hereto-
fore, to receive time deposits and to pay interest on the same."

Section 19 provides in part that—

"Demand deposits within the meaning of this Act shall comprise all deposits payable within thirty days and time deposits shall comprise all deposits payable after thirty days and which are subject to not less than thirty days' notice, and all postal savings deposits."

In the original House bill, provision was made for the creation of savings departments, but this provision was eliminated by the Senate and agreed to by the conferees. In its stead, provision was made, authorizing the bank to pay interest on deposits and including savings accounts in the interest-bearing deposits.

In regard to the savings accounts of National banks, the Board says in its 1915 report:

"Under regulations carefully developed by the Board, it has sought to limit the number of accounts against which reserve of 5% (later reduced to 2%) has been permitted to those which are beyond question what they profess to be, the reduction, therefore, involving no element of danger to the liquid condition of the banks. Despite this care, some State officials have considered it their duty to attempt to restrict the development
of the savings deposit function of National banks, and in California this attitude has been carried so far that the Board has recommended to the Federal Reserve Bank the institution of injunction proceedings, designed to protect the rights of member banks."

The reduction of cash reserves against such of the business of a National bank as represented by deposits which are subject to not less than thirty days' notice from the old requirement of from fifteen to twenty-five per cent to the new basis of three per cent makes a vast difference in the amount which our National banks must deposit with reserve agents. Savings accounts are much more stable than checking accounts and the withdrawals, as shown by experience, are very regular. As a result, the bank can with perfect safety keep the lower reserve provided for by the Federal Reserve Act and can invest the balance in less liquid assets than the necessities of the ordinary checking business would demand. The investments of savings banks are in some States strictly limited, and under the provisions of the Federal Reserve Act National banks have a distinct advantage in being less narrowly restricted in the employment of savings deposits.

Loans on Farm Land and Other Real Estate

Of all the restrictions in the National Bank Act, those upon loans were by far the most serious handicap to country banks in competing with State institutions. Prior to the passage of the Federal Reserve Act, rural banks had, in fact, taken land into account in making loans and in various ways made it the security for many of their loans.

While the Federal Reserve Act was under consideration in Congress a strong demand came from banking institutions in the West and South that National banks be given the privilege of making farm loans, but it was admitted by practically every advocate of the extension of this power to National banks that it should be limited to a certain proportion of the bank's capital, or with reference to some fixed percentage of its time deposits.

The Federal Reserve Act as originally passed by Congress authorized any National bank, except those located in Central Reserve Cities, to make loans up to 25% of its capital and surplus or 33 1/3% of its time deposits on improved and unencumbered farm land, under certain specified conditions. In an Act approved September 7, 1916, this section of the Federal Reserve Act was

amended so as to empower any National bank, except those located in Central Reserve Cities, to lend 25% of its capital and surplus or 33 1/3% of its time deposits on any improved and unencumbered real estate, as distinguished from farm land, provided such real estate is located within 100 miles of the place in which the lending bank is located, up to 50% of the value of the property. Farm loans are limited to five years and other real estate loans to one year. The Federal Reserve Board has power to add from time to time to the list of cities in which National banks are not permitted to make such loans.

The purpose of this provision is to enable banks to make loans to farmers who have little beside land to offer as security, and who require funds for a considerable period to carry on their operations. It has never been claimed that section 24 of the Federal Reserve Act would meet all of the requirements for long time loans, but adequate provision has been made under the Federal Farm Loan Act whereby the Farm Loan Board has established a system of farm loan banks in the United States, which banks are authorized to make loans over long periods of time.

The power to lend on farm land and other real estate is a distinct advantage to National banks. It gives them more of the most profitable kind of local business on which the returns are greater than they could
secure by lending their funds in the money centers or using them in the purchase of paper from note-brokers. The ability to lend on farm land and other real estate brings desirable customers to the bank who would otherwise establish banking connections elsewhere. Furthermore, by assisting in the growth of wealth in its community, the bank advances its own interests and lays a solid foundation for its future expansion.

Foreign Branches of National Banks

Of the powers granted to National banks by the Federal Reserve Act, none, perhaps, is more significant or fraught with greater possibilities than those conferred for the purpose of financing our foreign trade. It had long been realized that the foreign trade of the United States was very inadequately financed and that in many cases Americans engaged in foreign business were unable to get the accommodations which they required. Under section 27 of the Federal Reserve Act, any National bank having a capital and surplus of not less than $1,000,000 may establish foreign branches under regulations of the Federal Reserve Board. So far, only two National banks have applied for this power, The National City Bank of
New York and The First National Bank of Boston. The former has undertaken the task upon a large scale.

Section 25 of the Federal Reserve Act, as amended by the Acts of September 7, 1916 and September 17, 1919, authorized a National bank having a capital and surplus of $1,000,000 or more to invest, under certain circumstances, in the stock of corporations chartered or incorporated under the laws of the United States, or of any State thereof, and principally engaged in international or foreign banking, and authorized any National bank, until January 1, 1921, without regard to the amount of its capital and surplus, to invest, under certain conditions in the stock of one or more corporations incorporated under the laws of the United States, or of any State thereof, and principally engaged in such phases of international or foreign financial operations as might be necessary to facilitate exports from the United States or any of its dependencies. At that time, however, Congress had not provided any means for the Federal incorporation of foreign banking corporations or other foreign financial corporations in whose stock National banks were authorized to invest. In the enactment of section 25(a) of the Federal Reserve Act, approved December 24, 1919, Congress provided a means for the incorporation of institutions under Federal law for the
purpose of engaging in international or foreign banking or other international or foreign financial operations in whose stock National banks, as well as individuals, firms and other corporations may invest.

The provisions of the so-called Edge Act which constitutes section 25(a) permit a National bank, regardless of the amount of its capital stock to invest up to 10% of its capital and surplus in the stock of corporations organized under the provisions of that section and engaged either in foreign banking operations or in the foreign investment business, but the aggregate of all investments made by a National bank under the provisions of section 25 and 25(a) must not exceed 10% of its capital and surplus.

The primary purpose of the Edge Act was to provide for the establishment of a Federal system of international banking or financial corporations operating under Federal supervision with powers sufficiently broad to enable them effectively to compete with similar foreign corporations and to afford to the American exporter and importer at all times a possible means of financing his foreign business.

The immediate effect of the operation of cor-

porations under this Act, however, has been to greatly aid in extending long-term credits to Europe. The overwhelming balance of our exports over our imports that first developed during the war has continued, due to the fact that since the Armistice Europe has needed raw materials in great quantities in order to reestablish her industries, together with an immense amount of imported foodstuffs, while a resumption of normal production has been prevented by political and economic disturbances.

Since the passage of the Edge Act, two international financial corporations have been organized under the terms of that Act, one with a capital stock of $2,100,000 and the other with a capital stock of $7,000,000. Last October, a committee of the American Bankers Association presented a report at the Washington convention which included a proposal for the formation of another corporation with a capital stock of $100,000,000. Arrangements are now being made for the completion of the organization.

Acceptances

The Federal Reserve Act, however, made provision not only for the mechanism for conducting foreign trade, but also for the establishment of practical business methods by legalizing the use of acceptances maturing
within six months, arising from the foreign trade of the United States and other countries. An amending act of September 7, 1916, authorized the acceptance of domestic bills, accompanied by shipping documents or secured by warehouse receipts for readily marketable staples.

Under the amendment of September 7, 1916, provision was also made for the acceptance by National banks of bills of exchange having not more than three months to run (exclusive of days of grace) for the purpose of furnishing dollar exchange as required by the usages of trade in foreign countries or dependencies, or insular possessions of the United States.

Bankers acceptances have been rendered eligible for rediscount at the Federal Reserve Banks and this has given them a higher degree of liquidity than would otherwise have characterized them.

The Federal Reserve Act had defined a bank acceptance as "a draft or bill of exchange of which the acceptor is a bank or trust company, or a firm, person, company or corporation engaged in the business of granting bankers' acceptance credits". The character of the instrument may be further explained by an illustration. A, a merchant in London, ships goods to B in America. A desires a credit which will enable him to liquidate promptly, and B agrees that A's draft for the goods shall
be accepted by a New York bank. B may have protected his bank in some special manner, if the institution so re-
quired, or he may simply have made a satisfactory statement on the strength of which the bank had agreed to accept A's draft for a commission, with the understanding, of course, that B will place in the bank's hand funds with which to meet the draft several days before it matures. One banker has defined the bank acceptance as follows: "From a banking standpoint in American, a bank acceptance is nothing but the certification of a time draft by the bank on which it is issued. The certification of a check, which is the only one mentioned in some of our banking laws, binds the bank to pay the check on presentation, whereas the acceptance of the draft binds the accepting bank to pay the same at maturity".

Prior to the passage of the Federal Reserve Act our National banks were not permitted to make acceptances, and while there was nothing to prevent State banking laws from legalizing their use, such laws, which were usually modeled upon the National Bank Act, either ignored or prohibited their use.

A trade acceptance differs from a bank acceptance in that the trade acceptance is drawn by the seller of merchandise upon the buyer, for the amount of the
invoice, and bears upon its face the signature of the buyer, together with the date and place of payment. It is simply a negotiable promise to do exactly as the buyer agreed to do when the goods were ordered.

The advantages to the banker of the trade acceptance introduced under the operation of the Federal Reserve Act are of importance. This two-name paper constitutes a secondary reserve, as it can be easily rediscounted at the Federal Reserve Banks at preferential rates. The trade acceptance represents a commercial transaction, which is not always true of single-name paper. Furthermore, a customer who settles his accounts by trade acceptances is not likely to sell his book accounts, borrow through brokers or apply at other banks for credit, because he knows that his bank, if a member of the Federal Reserve System, can take care of his needs. Finally, the trade acceptance system is an important factor in keeping the credit system sound.

Trade acceptances are now used throughout the United States in practically every line of business, are included in the terms of sale of thousands of business concerns and are discounted freely by progressive bankers of the country. However, the trade acceptance has not made the headway that it merits largely because of the attitude
of the banker. There are a large number of bankers in every section whose study of credit conditions has not gone far enough to enable them to realize the great advantages of this credit instrument to themselves and their clients as an aid to better morals in business and better credit and banking conditions.

Of all the provisions made by the Federal Reserve Act, none is of greater importance than that relating to bankers’ acceptances. From the standpoint of financing our foreign trade, it is of the utmost significance. Under the old system, our foreign trade had to be financed in London and on the Continent, and the expression "dollar exchange" which is now heard so frequently was merely an ideal far removed from practical realization. Under the provisions of the Federal Reserve Act, our importers are no longer required to pay London an annual tribute in the way of acceptance commissions. Our exporters, also, are freed from dependence upon London and can now bill their shipments in dollars.

Our domestic trade has also benefitted by the legalization of bankers' acceptances. Under our banking system prior to the corrective legislation of 1913, our merchants and manufacturers were forced to pay

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current local rates for money because of our lack of a true discount market. Under the present system, every merchant whose local credit is good can count on being able to sell his paper throughout the Reserve District in which he is located, and also, in a lesser degree, throughout the country, and will get the best rate of commercial credit prevailing anywhere within his locality. Furthermore, borrowers now have the advantage of foreign competition for their paper from which formerly they were excluded, with the exception of the largest and strongest, due to the fact that the acceptance is salable wherever the accepting bank is known.

The advantages of the acceptance to the banks themselves are important. Banks in money centers which were formerly deprived of this type of security in which to invest their money, and which as a result invested their funds principally in trade paper and stock exchange loans, may now purchase bills of exchange which cover genuine commercial transactions and which bear the acceptance of a prime bank. The field for the investment of the deposits of city banks has been greatly broadened, both to the advantage of the banks themselves and of trade in general.

Country banks under the limitations of the National Bank Act either deposited their surplus funds with
reserve agents at a very low rate of interest, invested in
bonds, which always carry the danger of speculation, or em­
ployed them in the purchase of paper from note-brokers.
The latter method brought a greater interest return, and was
free from speculation, but it meant the tying up of the
bank's funds for a considerable time, and, furthermore,
banks buying such paper were forced to depend upon the
opinion of note-brokers or correspondent banks in regard
to the financial responsibility of the makers of the
notes. These banks may now invest in paper which has back
of it the credit of some great bank whose standing is un­
questioned. Bank acceptances are regarded as the best
quick asset for a bank's portfolio, and they almost con­
stitute a supplementary cash reserve due to the fact that
they may be easily and quickly converted into cash in
case of emergency.

Broker, Insurance Agent, Etc.

In addition to the powers above referred to,
an amendment to the Federal Reserve Act, approved
September 19, 1916, permits National banks operating in
places having a population of not over 5000, under
regulations prescribed by the Comptroller of the
Currency, to act as Agent for fire, life or other insurance companies authorized to do business in the State. An additional provision permits National banks in the same centers to act as broker or agent for others in making or procuring loans on real estate located within 100 miles of the bank's home. The bank is allowed to charge commissions for services so rendered or accept fees for its work. Prior to the granting of this power, bank officers in such localities very often combined their duties as officers with insurance and other similar business, but in the latter capacities they acted, not for the institution, but as individuals. Under the present law, when a bank takes over the business which was previously conducted by the officers in their individual capacity, such officers are deprived of an outside income. No bank is allowed to guarantee the principal or interest of any loan, the payment of insurance premiums, or the truth of any statement made by an applicant for insurance. Business affiliations in small towns are often close and some banks have hesitated about entering into competition with their own customers who are already in the insurance business.

Shortly before the passage of this amend-
ment, a conference of Canadian bankers and the dealers in the Western prairie provinces of Winnipeg was held at which the dealers charged that branch banks were taking up agencies for the placing of insurance. They objected to this assumption of an outside enterprise, and the heads of several chartered banks promised them that the practice would be stopped. Thus, while the heads of leading banks of one country, after some years of experience, had decided that the banks must go out of the insurance business, our own country passed a law permitting National banks, as institutions, in moderate sized towns, to take over this business.

Without attempting to summarize the facts of this chapter, it is in place to state that the Federal Reserve Act has accomplished two purposes in a very conspicuous manner. It has unified our banking system by enabling National banks to enter into active competition with State banks and trust companies in sundry lines of business which have always ranked as the most profitable carried on by State institutions. The banks retain the advantages of competition and yet they are so grouped and assembled as to make it possible to use reserve resources jointly and effectively for the
benefit of all and the protection of the public. Furthermore, it has placed our banks in a position to make American financial influence abroad felt more fully than ever before.
CLEARING AND COLLECTION OF CHECKS

In a discussion of a piece of banking machinery so essentially modern and American as the Federal Reserve Check Collection System, it is necessary to review the difficulties and evils attending the unsatisfactory and unsound methods of handling country checks which existed for many years prior to the establishment of the Federal Reserve Banks. It is only in this way that an appreciation of the merits of the system now in force in the several Federal Reserve districts can be gained.

Among the very numerous criticisms of our banking system made by the National Monetary Commission which submitted its report to Congress in January, 1912, appeared the following:

"We have no effective agency covering the entire country which affords necessary facilities for making domestic exchanges between different localities and sections, or which can prevent disastrous disruption of all such exchanges in times of serious trouble."

Prominent among the defects of the old system were excessive exchange charges, especially by banks in the West and South, caused by the wastefulness of the
independent system of collections. In order to reduce or avoid exchange charges, practices were resorted to which increased the delay and waste in the system. In the first place, checks were sent by roundabout and devious routes in order to find a possible route open without exchange charges. This method was made possible by agreements between correspondent banks to pay checks for one another at par. In the second place, banks found it necessary to maintain exchange balances with banks in distant cities which, in return, rendered free collection service. This meant the tying up of large sums in scattered deposits with correspondent banks at low rates of interest. These exchange balances were regarded as part of the lawful reserves.

One serious phase of the practice of routing checks was the manner in which it padded legal reserves. Reserve-holding banks, under stress of competition for the accounts of out-of-town banks, were accustomed to give immediate credit for items sent to them by country banks which sometimes required a week to collect. To illustrate: A bank in Chicago would give immediate credit to a bank in Iowa for such checks drawn
on Minneapolis, Denver and Salt Lake City as the Iowa bank might send to its Chicago correspondent, thereby undertaking to collect checks on Minneapolis, Denver and Salt Lake City, and, in the meantime, paying the Iowa bank the face value of the checks upon receipt. Moreover, when the reserve city bank received checks from its correspondents, it would send some of them to the central reserve city bank and count them as reserve as soon as they were placed in the mail. Frequently, a check which had been counted as reserve by the various banks was returned for want of funds.

The exchange balances were regarded by the banks holding them as essentially the same as other deposits and no special reserves were kept against them. But in times of trouble, the individual banks, in an attempt to strengthen their own position, would draw against these balances and often insist upon shipments of currency. Consequently, the reserve-holding banks were weakened, and the usual result in times of panic was a complete breakdown of the domestic exchanges.¹

¹ Conway and Patterson, op. cit., p.207.
Another serious difficulty for which the old system was largely responsible was the need of heavy shipments of currency back and forth over the country to meet the seasonal demands. These shipments amounted in a year to hundreds of millions of dollars and involved the expense of packing, shipping, abrasion and interest items.

Referring again to excessive exchange charges, the first noted among the defects of the old system, American commerce suffered severely from the infliction of high collection charges upon business for check collection, and this practice was carried so far that in the hearings which preceded the enactment of the new bank act, country bankers testified that in many instances such charges constituted fully one-half of their earnings and they could not get along without them. Banks maintained exhorbitant rates by agreements among themselves and developed a code of so-called "banking ethics", which prevented them from cutting the excessive charges, even had they been disposed to do so. A check was regarded as something out of which as much profit as possible was

1 J. T. Holdsworth, op. cit., p. 220.
to be made, and no particular bank or group of banks can be singled out as the prime offender in this; all alike were guilty to a greater or less degree. However, New York, although the financial center of the country, made no attempt to better its transit methods, and the need for reform in that section was so glaringly obvious that in 1912 the accusation was made that the New York banks were making excessive profits in collections. In the hearings before the Pujo Committee which was investigating the "Money Trust", it was charged that the New York banks realized about $50,000,000 a year from this source. According to the New York banks themselves, the gross income to the members of the Clearing House Association from collection exchange during the year 1911 was $2,042,551. From this must be deducted, as exchange cost, postage, rent, stationery, salaries and loss of interest, totalling $2,042,083.78, leaving a net income of $97,467.22. Without attempting to draw conclusions in regard to the matter, it is, nevertheless, evident from the rules of the

1 Conway and Patterson, op.cit., p.325.
New York Clearing House that New York banks attempted to shift to their customers' shoulders the expense of check collection. The country was divided into three groups, the charges upon all cities within each group being uniform. The first group consisted of those cities near New York known as discretionary points. On these points each bank was permitted to exercise its own discretion as to charges and in practice none were made. The remainder of the country was divided roughly by the Mississippi River. A uniform rate of $\frac{1}{10}$ of 1% was charged on all points east of that line and $\frac{1}{4}$ of 1% on all points west of it. Unlike country banks, however, the banks of New York City did not deduct from the face of their own checks.

In Philadelphia another device was used which accomplished practically the same purpose as the plan of the New York banks. The large banks paid interest on the deposits of country banks, but interest began immediately only on items on discretionary points. The remainder of the country was divided into three districts. Interest began on checks drawn on banks in the first district only after three days, on those drawn on banks
in the second district after five days and on checks drawn on banks in the remainder of the country only after seven days.

Many attempts were made by Clearing House Associations to reform the methods used in check collection, but they usually were unsuccessful owing to lack of cooperation by the banks in the various collection centers. Progress was made, however, in some sections of the country, notably Boston and Kansas City, where clearing house systems were put into operation. It was in New England that the first attempt was made to ameliorate the unsatisfactory conditions which attended the collection by Boston banks of checks on neighboring States. The plan finally adopted in 1900 was that of a clearing house foreign department—a country clearing house—for the purpose of clearing such checks. Each bank, instead of sending individual letters each day to its country correspondents, "lumped" its country checks and forwarded them to the clearing house where they were re-sorted and sent by the clearing house to the banks on which they were drawn. Settlement was made through the regular clearing house in two days, which was the
time required for collection. If this system had been general, it would have been unnecessary for the framers of the Federal Reserve Act to include the clearing function among the powers of the Federal Reserve Banks.

This plan was so successful that five years later when Kansas City and its surrounding district found itself in the same predicament, another clearing house was established. The Country Clearing House Department of the Kansas City Clearing House Association covered the States of Missouri, Kansas, Nebraska, Colorado, New Mexico, Oklahoma and Texas and included more than five thousand banks. The Kansas City Country Clearing House did not interfere with the arrangements of the individual banks—it merely offered its members the additional facilities which it afforded. It effected a saving of over 50% in the gross expense of handling transit items in its territory and reduced the time required for collection about 25%.

Devices similar to the country check clearing house systems referred to above were developed in several other sections of the country, notably the middle west. Some cities became known as free cities.
Others, however, were notorious for their high collection charges. Many banks made collection charges—some excessive and some reasonable—for the collection of out-of-town items presented at their own counters.

Numerous efforts made to combat the evils just referred to met with little success. At a meeting of the Reserve City Bankers Association held in St. Louis in April, 1913, eight months before the Federal Reserve Act was passed, the following resolution was adopted:

"Resolved, That the Association of Reserve City Bankers does hereby endorse the recommendations submitted by the Committee for the consideration of Clearing House Arrangements in Reserve City Banks for the handling of country items, and that it be the sense of this Association that a copy of these recommendations as submitted be printed and mailed to every bank president and to the president of every Clearing House and members of this Association in the fifty reserve cities of the country, and that there be embodied therewith a statement, not to exceed 600 words, by a representative of the four Clearing Houses in Boston, Kansas City, Nashville, and Atlanta, where country clearing houses are now
established, showing briefly the plan adopted and the results obtained."

Copies of the recommendation were sent to 50 reserve cities, but with practically no results. Although many bankers in the reserve cities strongly advocated the country clearing plan, it was not possible to persuade all members to agree to its adoption. Even had they done so, it would have taken a long time to completely cover the country with country clearing house departments.

From this review of the slow, wasteful antiquated system of check collection in vogue in the United States at the time the Federal Reserve Act was passed, we are in a position to appreciate the difficult and complicated problems confronting the Federal Reserve authorities in the early days of the new system. Technical problems arose out of the unwillingness of bankers to lose the profits growing out of exchange charges. It was also argued that neither the Federal Reserve Board or the Federal Reserve Banks had power to permit items drawn

1 C.R. McKay, Deputy Governor, The Federal Reserve Bank of Chicago, "Check Collection System of the Federal Reserve Banks, an address delivered before Officials of Bankers Association of the Central States at Chicago, March 10, 1920."
on them to be charged against their accounts by the Federal Reserve Banks immediately upon receipt. While the Board was little disturbed by the opposition arising from self-interest, it felt that it must take cognizance of all legal objections and requested the opinion of the Attorney General in regard to its power in this connection. The Board clearly recognized that the clearing question was essentially a reserve problem, and as the Federal Reserve Act gave the member banks three years in which to make the final transfer of reserves to Federal Reserve Banks, and as balances with city correspondents counted as reserve in the meantime, it felt that the banks were partly justified in objecting to the immediate introduction of a complete clearance at the Federal Reserve Banks. The Board also recognized that until a large number of State banks entered the system, it might be necessary for some member banks to use the collection facilities of their correspondents in reserve cities. The difficulties of a compulsory plan and the possible merits of a voluntary system were presented to the Board by the Governors of the respective Federal Reserve Banks who had thoroughly investigated the situation, with the result that the Board took under favorable consideration the question of a voluntary clearing
Before the Board promulgated its voluntary plan, however, the Federal Reserve Banks of Kansas City and St. Louis, with the approval of the Federal Reserve Board, inaugurated a complete system of intra-district clearing, embracing the handling of checks on all member banks in their respective districts. Under this plan, checks were received from member banks, drawn on any other member banks of the district, without charge for collection, and immediate credit was given for such checks. Likewise, immediate charge was made to the account of each member bank covering all checks drawn on such bank.

The Federal Reserve Board announced on March 4, 1915, that it had determined to direct the introduction of a voluntary reciprocal plan for immediate clearance at all Federal Reserve Banks where a clearing plan was not already in operation. Federal Reserve Agents were instructed to take the matter up with their boards of directors at once. The Board did not attempt to prescribe details but left that matter under the control of the bank officers. The plan was similar to that in

1 Second Annual Report of The Federal Reserve Board, 1915, p. 15
2 Federal Reserve Bulletin, May, 1915, p. 6
force in the Kansas City and St. Louis districts, except that it applied only to checks drawn on such banks as expressed their willingness to have checks on them cleared through their Federal Reserve Bank. Each bank joining the system agreed to provide the funds above the reserves required to meet clearing demands. Banks were permitted to withdraw from the clearing system on thirty days' notice. This system became effective in most districts during June, 1915. In the Kansas City district, the original plan was continued for the benefit of the 950 member banks, but the Federal Reserve Bank of St. Louis offered its members the option to withdraw from the clearing system and about 20% took advantage of the opportunity, leaving about 365 banks in the system.

The banks did not take enthusiastically to the plan, and the disappointment of the Board is expressed in its 1915 report:

"Outside of these two districts (Kansas City and St. Louis) about 1,100 member banks voluntarily affiliated themselves with the clearing system within a short time after its inauguration, and there was a subsequent net inward movement of about 50 additional
members, making approximately 1,150 banks which of their own free will have assented to the voluntary clearing plan. This is considerably less than 25 per cent of the institutions eligible for membership, and the proportion has been so small as to prove a severe disappointment to those who had confidently expected that the foresight and enlightened self-interest of the member banks would speedily accomplish the desired result. This slowness is largely due to the failure of jobbers and merchants to appreciate the advantages of the clearance system and to enlarge its membership by insisting that their own banks join and cooperate in the plan."

On December 31, 1915, the total number of items cleared through the Federal Reserve Banks was 9½ millions, amounting to nearly 5½ billion dollars. Serious difficulty resulted from charging checks to the accounts of member banks immediately upon receipt by the Federal Reserve Banks. This method, which had seemed highly desirable in theory because it made checks immediately available as reserve for member banks, in practice caused large overdrafts in the accounts of banks on which the checks were drawn, the total overdrafts sometimes amounting to several million dollars. It became increasingly evident that the
voluntary system of clearance and collections was not likely to reach such a plain of efficiency as to make it a substantial factor in the clearance and collection system of the country. In April, 1916, the Board decided to establish a more uniform and comprehensive system of clearance and collections, and on May 1, 1916, issued a circular entitled "Check Clearing and Collection", announcing its country-wide clearing plan. The provisions of this circular can best be set forth by quoting from the press statement given out by the Board and which also appeared in the May, 1916, Federal Reserve Bulletin:

(1) The Federal Reserve Banks will accept at par all checks from member banks, whether drawn against member banks, nonmember banks, or private banks. An exception is made at the outset in the case of checks drawn against nonmember banks which cannot be collected at par.

(2) All checks thus received from member banks will be given immediate credit entry, although amounts thus credited will not be counted as reserves nor become available until collected.

(3) In order to enable member banks to know how
soon checks sent in for collection will be available either as reserves or for the payment of checks drawn against them, time schedules, giving the minimum time for collection, will be furnished by each Federal Reserve Bank to its member banks.

(4) The actual cost, without profit, of the clearing and collection of checks will be paid by the Federal Reserve Banks and assessed against the member banks in proportion to their sendings.

(5) The whole plan is based on generally accepted principles under which clearing and collection plans have long been operated. A Federal Reserve Bank will not debit a member bank's reserve account with items forwarded to it for collection until the remittance of the member bank in payment of such items shall have had time to reach the Federal Reserve Bank.

The time schedule was worked out on the basis of the mail time required for items to reach the paying bank, plus the mail time required for the paying bank to remit to the Federal Reserve Bank of its district. To illustrate: Rules of the New York bank give immediate credit for checks on practically all of the New York
banks. One day is required for checks on Boston, Philadelphia, and other nearby points. Most points in the East require two days, and the maximum time for points in the extreme West is eight days.

The system was not compulsory for any bank, but every bank must keep the required reserve on deposit with the Federal Reserve Bank of its district and must pay without collection charges checks drawn upon itself and presented at its own counters for payment, and remittances by the Federal Reserve Bank through the mail is regarded as such presentation. In case member banks are unable to send in offsetting checks on other banks, they may remit lawful money or Federal Reserve notes at the expense of the Federal Reserve Banks. On December 15, 1916, par collections were being made on over 15,000 banks. A collection charge averaging about 1\(\frac{1}{2}\) cents per item was assessed upon the member banks in proportion to the extent to which they used the collection facilities.

Immediately upon taking over the Boston Country Clearing House, the Federal Reserve Bank of Boston was

able to collect checks drawn upon any bank, both member and nonmember, located in New England. While the Federal Reserve Bank took over the country collections, the clearing house association was permitted to preserve its status as a voluntary association, maintaining supervision over its own members, conducting its daily clearings, and so forth. The equipment is furnished by the reserve bank, and the officers and clerks are employees of the reserve bank. But when the clearing balances are once established, all settlements are made through the reserve bank.

At the time of the inauguration of the new system, Federal Reserve Banks were expressly required by section 16 to "receive on deposit at par from member banks or from Federal Reserve Banks checks and drafts drawn upon any of its depositors. In the case of receiving checks on nonmember banks for collection, the Board was advised by its counsel that this constituted one of its implied powers conferred by that part of section 4 which states that Federal Reserve Banks may exercise"such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this Act". The right to receive deposits and act as a clearing house

implies the right to receive checks for collection and credit. But in order that there might be no doubt about this implied power, Congress on September 7, 1916, amended section 13 by an act which, among other things, permitted, but did not require Federal Reserve Banks to receive deposits of all "checks and drafts payable upon presentation". This removed all doubt as to the right of a reserve bank to exercise its own discretion in accepting for collection checks drawn on nonmember as well as upon member banks.

With a view to making the clearing and collection system more complete and comprehensive, Congress on June 21, 1917, amended section 13 so as to allow Federal Reserve Banks to receive at par from any nonmember bank or trust company, for the purpose of exchange or collection, deposits of "checks and drafts payable upon presentation, or maturing notes and bills", when such nonmember banks and trust companies agree to remit at par checks drawn upon themselves and to maintain a compensating balance with the Federal Reserve Bank, the amount to be determined by the Federal Reserve Bank.

1 Senate Document # 184, pp. 2, 3.
This amendment was intended primarily for those non-member banks that were ineligible for membership, either because of a lack of sufficient capital or otherwise. It was, second, to permit both member and nonmember banks—

"To make reasonable charges, to be determined and regulated by the Board, but in no case to exceed 10 cents per $100 or fraction thereof, based on the total of checks and drafts presented at any one time, for collection and payment of checks and drafts and remission therefor by exchange or otherwise."

But it was expressly stipulated that—

"No such charges shall be made against the reserve banks."

This amendment, known as the Hardwick amendment, is the last change in the law relating to the collection of checks. The exchange-charging banks, especially those in the South and West, fought this measure vigorously, but were unable to defeat it. All banks were required to remit at par. The Board requested an interpretation of the provisions and it
was construed by the Attorney General and recently held by the United States Circuit Court of Appeals, Fifth Circuit, as prohibiting Federal Reserve Banks from paying exchange charges to member or nonmember banks.

At the close of the year 1917, the costs of collection, averaging about 1/10 of 1 1/2 cents to 1 1/2 cents per item were assessed upon member banks in proportion to the extent to which they used the collection facilities. On July 1, 1918, all service charges were abolished, and the Federal Reserve Banks also assumed the costs of postage, telegrams, insurance and other expenses in connection with check collection, currency shipments, exchange transfers and deposit transactions between the member banks and the Federal Reserve Banks. Practically the same facilities were extended to clearing member banks. A further service to nonmember banks on the par list is provided by inclosing stamped envelopes with collection letters for remittances. The arguments presented by country banks for refusing to remit at par were thereby effectively

1 Sixth Annual Report of the Federal Reserve Board, 1919, p. 64.
The number of par banks grew slowly until at the end of 1918 out of 29,000 banks in the United States, 18,977 remitted at par.

On December 7, 1918, at a conference of Federal Reserve Agents held in Washington, the conclusion was reached that an active campaign should be started to extend the par list and establish a country-wide par system. It was recognized that the number of banks which refused to remit at par was sufficiently large to cause many banks to hesitate to make use of the Federal Reserve collection system because of the number of items which could not be handled by the Federal Reserve Banks. As the result of correspondence and personal solicitation, nearly 10,000 more banks were added to the clearing system by the end of 1919. It is chiefly in connection with the extension of the par list to include nonmember banks that the present controversy has arisen. If the Federal Reserve Banks in their capacities as clearing houses are to render efficient service to their...
member banks. They must be able to clear checks drawn on all banks, member banks, nonmember banks or private banks, whether or not they agree in advance to remit at par. The Board is thoroughly convinced of the advantages of a universal system for the par collection of checks, and the Federal Reserve Banks have had its unqualified approval, not only in their efforts to persuade nonmember banks to remit at par, but also in their practice of presenting over the counter checks drawn on nonmember banks which refuse to remit at par.

In the second course, the Federal Reserve Banks have employed suitable agents for the purpose. These agents may be a member bank located in the same city as the drawee bank, a nonmember bank, an express company, or any suitable person or corporation able to make collection over the counter of the drawee bank.

Opposition on the part of the banks against par collection has taken various concrete forms. For instance, some banks, including some member banks, have resorted to the device of stamping notations on their checks.
blank checks to the effect that the check is not valid if presented through the Federal Reserve Banks. Employees and agents of the Federal Reserve Banks in making presentation of checks have sometimes been offered silver dollars in payment, and in some cases have been refused payment, the drawee bank relying on the inability of the agent to find a notary public willing to make protest. The Board reports that one agent announced a few days after his appointment that he would no longer act as agent through fear of injury to his business.

The stiffest fight against par collection appears to have taken place in Pierce, Nebraska. It was alleged that the Federal Reserve Bank of Kansas City had intentionally held up items for the purpose of presenting them in bulk and demanding payment in cash so as to embarrass the drawee bank and enforce par remittance.

The allegations became so serious in regard to the methods used by the employees of the Omaha branch of the Federal Reserve Bank of Kansas City that

1 Senate Document # 164, pp.4,5.
2 H.H.Preston, op.cit.,p.574
a special meeting of State bankers of Nebraska was held at Omaha on January 14, 1920, to consider the matter of par collections. The practices of the Federal Reserve Banks were severely criticized and resolutions were passed asking representatives in Congress to demand an investigation of the methods employed by the Federal Reserve Board. Senator Norris of Nebraska presented the matter to the Senate on January 19, 1920, and a resolution was passed "requesting the Federal Reserve Board to inform the Senate whether the Board or any Federal Reserve Bank, under instructions or with the consent or knowledge of said Board, had resorted to any method of coercion to compel State banks to join the Federal Reserve System, or by threats or other coercive means has attempted to require such State banks to submit to any rules or regulations made by the Federal Reserve Board or any Federal Reserve Bank".

In answer to the Senate resolution, Governor W. P. G. Harding submitted a letter to the President of the Senate, containing a brief review of the development of the check clearing and collection system now
in force in the various Federal Reserve districts, to­
gether with a summary of the provisions of the law and
amendments thereunder which the system has been
organized and operated. The letter also contained a
complete statement of the position of the Board. The
report as a whole is an excellent defense of the
system. The letter was printed as Senate Document
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The opposition to par collections has also
been very vigorous in the southeastern States. The
legislatures of Mississippi, Louisiana, Georgia and
Alabama have passed laws requiring all banks within the
State, including National banks, member banks and non-
member banks to make charges "for collecting and re-
mitting " cash items which " are presented to the payer
bank for payment through or by any bank, banker, trust
company, Federal Reserve Bank, post office, express
company, or any collection agency, or by any other
agency whatsoever". The law of the State of Missis-
ippi which became effective March 8, 1920, is

1
H. H. Preston, op. cit., p. 575.
mandatory, but those of the other four States simply purport to authorize all banks within the State to make collection charges. The laws of these four States prohibit officers from protesting any check when non-payment is solely on account of refusal to pay the exchange. The legislature of South Dakota has also passed similar laws. The Federal Reserve Board has taken the position that these laws are unconstitutional inasmuch as they purport to require National banks and State banks which have joined the Federal Reserve system to make exchange charges against Federal Reserve Banks. The lawmakers of Mississippi evidently had some serious doubts as to the constitutionality of the law for they provided that in case the Courts held that National banks are not required to charge exchange, "this Act shall still remain in full force and effect as to all other banks in the State".

Pending the decision of the United States Supreme Court, the Federal Reserve Board has refused

1 Sixth Annual Report of the Federal Reserve Board, 1919, pp. 63, 64.
to handle checks on Mississippi banks which were formerly on the par list.

Support has been secured for the cause of the State banks from the State Bank Section of the American Bankers Association, which at its convention in St. Louis, September 30-October 2, 1919, condemned the methods used in order to secure par collection.

Although the question of method is still under discussion, it has lately become subordinate to the principal of par collection as such. A National Association of bankers was formed in New Orleans on February 6, 1920, called the National and State Bankers Protective Association. A number of National banks were represented at the meeting. A resolution was adopted to request Congress to amend the Federal Reserve Act to prohibit the handling by Federal Reserve Banks, either for deposit or collection, of any checks drawn on nonmember banks, unless such banks are clearing members. On February 28, 1920, a resolution introduced by Representative King of Illinois, in

Journal of the American Bankers Association XII, No. 9, p. 562.
compliance with the demands of the National and State Bankers Protective Association, was referred to the Committee on Rules. As yet, no action has been taken thereon.

While the opposition apparently comes from a comparatively small number of banks, seeking to protect their own profits, it is strong and well organized. There is no doubt that without political interference the opposition would be met and overcome because of the sound principles underlying the check collection system. However, support for the system is not lacking among the business interests of the country. The appeal now before Congress is to pass an amendment to the Federal Reserve Act, recognizing the right of banks to charge exchange when paying checks drawn by their own depositors and to repeal that part of the Hardwick amendment which specifies that no such charges shall be made against the Federal Reserve Banks, and it is for Congress to decide whether the par collection system shall be abolished or whether it shall become universal.

1 H. H. Preston, op. cit., p. 579.
When we consider the merits of the system, there can be little doubt as to the outcome. It was the idea of service and the desire to develop the functions of the Federal Reserve Banks to their utmost usefulness that led to the establishment and development of the check collection system. It has served as a solution of the exchange problem, as a remedy for the circuitous routing of checks which had resulted in the pyramiding of reserves, and as a means of correcting the generally unsatisfactory conditions which had prevailed for many years in this branch of banking. The best evidence of the value to the banks of the country of the Federal Reserve Collection System is the volume of business handled through it. A clear idea of the growth of the system since its establishment may be obtained by a glance at the development of the Gold Settlement Fund.

On January 1, 1921, checks on all but 1,755 of the 30,523 banks in the United States could be collected at par through the Federal Reserve Banks. These 1,755 banks are all located in the following seven States: Tennessee, South Carolina, Louisiana, Miss-
issippi, Alabama, Georgia and Florida. Consequently, every bank in nine of the twelve Federal Reserve districts is on the par lists, the three districts in which there are now any nonpar banks being those of Richmond, Atlanta and St.Louis.

There is every reason to believe that the Federal Reserve check collection system will be able to stand upon its own merits, and that Congress will uphold the decision of the United States Circuit Court of Appeals. The system, which is the result of years of study based upon experience, and to which more time and thought have been devoted than to all the other functions of the Federal Reserve Banks, seems to stand in need of explanation rather than defense. It is not unreasonable to hope that as nonmember banks learn more of its operations, they will perceive its benefits, and that the vast and as yet undeveloped possibilities of the system may be realized for the benefit of the member banks and through them for that of the nonmember banks and the public.

1 Sixth Annual Report of the Federal Reserve Board, 1919, p. 63.
Gold Settlement Fund

It may have suggested itself to the mind of the reader that the intra-district plan would probably not work well unless some system were devised for the clearance and collection of checks between districts. In the Federal Reserve Act, it was specified that the Federal Reserve Board might act as a clearing house for the Federal Reserve Banks, or might designate one of the Federal Reserve Banks thus to act. In pursuance of this authority, the Board at an early date took up the question of establishing a central clearing fund in the hands of the Board itself. A special committee of investigators appointed by the organization committee framed the plans for such a fund, and this plan as set forth in their report was subsequently adopted as the essential basis of the Board's plan of clearance. A committee composed of the governors of reserve banks assisted in arranging the details of the plan, but no important change was made in the general idea.

On May 8, 1915, the Board issued a circular and regulation providing for the establishment of the Gold Settlement Fund. By May 24th, each bank was required to forward to the United States Treasury or to a sub-treasury $1,000,000 in gold or gold certificates, plus its total net indebtedness to all other Federal Reserve Banks. The Treasury Department agreed to cooperate with the Federal Reserve Board in operating the fund and, under the arrangements thus concluded, the several assistant treasurers forwarded telegraphic advice of deposits to the Treasurer of the United States at Washington, who, in turn, issued gold order certificates of the $10,000 denomination, payable to the Federal Reserve Board, and these certificates in the hands of the Board made up the Gold Settlement Fund.

Under the Act as amended, additional safeguards have been thrown around the fund by permitting the Treasurer of the United States to carry a special account upon his books to the credit of the Federal Reserve Board, as agent for the respective Federal Reserve Banks and Federal Reserve Agents. Payments

1 Second Annual Report of the Federal Reserve Board, 1915, p. 79
are now made by checks signed by officials of the Board. The practice of issuing gold order certificates in denominations of $10,000, representing gold deposited with the Treasurer by Federal Reserve Banks has been discontinued.

On May 20, 1915, a preliminary settlement or clearing was made to ascertain the amount which each bank should deposit. The amount required, approximately $18,000,000, was deposited the following week.

In providing for clearings between the Federal Reserve Banks, the Federal Reserve Board agreed that the cost of operation of the Gold Settlement Fund and such shipments of currency as were necessary should be proportioned by semiannual accounting among the twelve Federal Reserve Banks.

On Thursday, May 27, 1915, the first regular weekly settlement was made. On the preceding Wednesday evening each Federal Reserve Bank forwarded to the Federal Reserve Board advice of the amount due the

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2 The Federal Reserve Bulletin, December, 1915, p. 401
several other Federal Reserve Banks. When the settlement was completed, telegraphic advice of the several credits, as well as the net debit or credit balance was sent to the banks. Upon receipt of this advice, each reserve bank charged the accounts of other reserve banks with the amounts it had reported due to them and credited their accounts with the amounts which they had reported due to it, and the difference between them equalled the net debit or credit to the Gold Settlement Fund, as advised in the telegram.

During the year 1916, the scope of the Gold Settlement Fund was enlarged by providing a similar fund for Federal Reserve Agents. Through the operation of these two funds, transfers may now be made between all of the Federal Reserve Banks, between any Federal Reserve Bank and any Federal Reserve Agent and between any Federal Reserve Bank or any Federal Reserve Agent and the treasury or subtreasury of the

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1 Second Annual Report of the Federal Reserve Board, 1915, p.79.
United States.

During the year 1917, there was a marked increase in the volume of business transacted through the fund, caused partly by a larger use of the collection and clearing facilities of the system, particularly in the matter of wire transfers from one Federal Reserve Bank to another, and partly by the fiscal operations of the Treasury in connection with the transfer of funds received from the sale of Certificates of Indebtedness and Liberty Bonds. Consequently, the Board deemed it expedient to install a system of daily settlements between the Federal Reserve Banks in place of the weekly clearings which had been in operation since the establishment of the fund in 1915. On July 1, 1918, the first clearing under the daily settlement plan was made. In order to further facilitate the daily settlements and to render the collection and clearing service more effective, a leased telegraph wire system connecting all of the Federal Reserve Banks and branches

1 Second Annual Report of the Federal Reserve Board, 1915, p. 79.
with the office of the Federal Reserve Board was in­
stalled July 1, 1918. Under this plan, at 10:00 A. M.,
Eastern time, each bank wired the settling agent of the
Federal Reserve Banks, who has charge of the books of
the fund, the amount which it had credited to other
Federal Reserve Banks the previous day, and the trans­
fer of funds from the credit of one bank to that of an­
other was made by means of book entries:

During the year 1919, the facilities of the
Gold Settlement Fund were extended to all branches of
the Federal Reserve Banks which carry accounts of
member banks. Additional facilities were provided in
the office of the Federal Reserve Board so that the
settlements are now effected more quickly for the twelve
Federal Reserve Banks and twenty-two branches than when
the settlements were made between the twelve Federal
Reserve Banks.

On March 1, 1920, an arrangement was made

2 Sixth Annual Report of the Federal Reserve Board, 1919, p. 44
effective whereby each Federal Reserve Bank and direct settling branch began telegraphing the Board the gross amount collected for the account of each other Federal Reserve Bank and direct settling branch before the final closing of the books for the day. Under this plan, settlement is now effected by the Board the same day and telegraphic advices are sent to each bank and direct settling branch to reach them before the opening for business the following morning, when the necessary entries are made and their books finally closed for the preceding day. Under the original plan, settlements were made each morning of the credits telegraphed the Board the preceding day. This plan has eliminated the inter-Federal Reserve Bank "float", which had previously been carried by some Federal Reserve Banks for other Federal Reserve Banks because of payments received by the correspondent Federal Reserve Bank one day in advance of payment through the Gold Settlement Fund.

Footnote 1
A comparison of the yearly combined clearings and transfers through the fund will give a clear idea of the growth in the volume of transactions.

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1915</td>
<td>$1,052,649,000</td>
</tr>
<tr>
<td>1916</td>
<td>5,757,836,000</td>
</tr>
<tr>
<td>1917</td>
<td>26,962,946,500</td>
</tr>
<tr>
<td>1918</td>
<td>50,242,592,000</td>
</tr>
<tr>
<td>1919</td>
<td>73,984,252,000</td>
</tr>
<tr>
<td>1920</td>
<td>92,625,805,000</td>
</tr>
</tbody>
</table>

Through the operation of the Gold Settlement Fund, it is possible to create, without cost, any amount of exchange that may be needed at any point where a Federal Reserve Bank or branch is located, as well as to obtain without cost immediate settlement for any amount of exchange that may accumulate.

The most noteworthy feature in the operation of the fund is the correcting of one of the serious defects of the old collection system which we have noted, namely, the necessity for heavy shipments of currency from one section of the country to another to
meet the seasonal demands for money. Transfers are frequently made from one district to another through the Gold Settlement Fund by simple bookkeeping entries. The June, 1917, Federal Reserve Bulletin states that heavy gold imports ultimately destined for the industrial and agricultural centers, from which had gone the exports of commodities, were transferred from New York through the Gold Settlement Fund. The Federal Reserve Bank of New York deposited gold with the sub-treasury for credit in the Gold Settlement Fund, and transferred the credit thus acquired to other Federal Reserve Banks.

The transferring of these enormous amounts of gold credits almost instantaneously by means of the leased telegraph wire system, without the physical movement of a dollar, has been of incalculable value to the Government, the banks and the public.
REGULATION C, SERIES OF 1920
(Superseding Regulation C of 1917)

ACCEPTANCE BY MEMBER BANKS OF DRAFTS AND BILLS OF EXCHANGE

A. ACCEPTANCE OF DRAFTS OR BILLS OF EXCHANGE DRAWN AGAINST DOMESTIC OR FOREIGN SHIPMENTS OF GOODS OR SECURED BY WAREHOUSE RECEIPTS COVERING READILY MARKETABLE STAPLES.

1. Statutory provisions.

Under the provisions of the fifth paragraph of section 13 of the Federal Reserve Act, as amended by the acts of September 7, 1916, and June 21, 1917, any member bank may accept drafts or bills of exchange drawn upon it, having not more than six months' sight to run, exclusive of days of grace, which grow out of transactions involving the importation or exportation of goods; or which grow out of transactions involving the domestic shipment of goods, provided shipping documents conveying or securing title are attached at the time of acceptance; or which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples. This paragraph limits the amount which any bank shall accept for any one person, company, firm or corporation, whether in a foreign or domestic transaction to an amount not exceeding at any time, in the aggregate, more than 10 per centum of its paid-up and unimpaired capital stock and surplus. This limit, however, does not apply in any case where the accepting bank remains secured either by attached documents or by some other actual security growing out of the same transaction as the acceptance. A trust receipt which permits the customer to have access to or control over the goods will not be considered by Federal Reserve Banks to be "actual security" within the meaning of section 13. A bill of lading draft, however, is "actual security", even after the documents have been released, provided that the draft is accepted by the drawee upon or before the surrender of the documents. The law also provides that any bank may accept such bills up to an amount not exceeding at any time, in the aggregate, more than one-half of its paid-up and unimpaired capital stock and surplus, or, with the approval of the Federal Reserve Board, up to an amount not ex-
ceeding at any time, in the aggregate, more than 100 per centum of its paid-up and unimpaired capital stock and surplus. In no event, however, shall the aggregate amount of acceptances growing out of domestic transactions exceed 50 per centum of such capital stock and surplus.

11. Regulations

1. Under the provisions of the law referred to above the Federal Reserve Board has determined that any member bank, having an unimpaired surplus equal to at least 20 per centum of its paid-up capital, which desires to accept drafts or bills of exchange drawn for the purposes described above, up to an amount not exceeding at any time, in the aggregate 100 per centum of its paid-up and unimpaired capital stock and surplus, may file an application for that purpose with the Federal Reserve Board. Such application must be forwarded through the Federal Reserve Bank of the district in which the applying bank is located.

2. The Federal Reserve Bank shall report to the Federal Reserve Board upon the standing of the applying bank, stating whether the business and banking conditions prevailing in its district warrant the granting of such applications.

3. The approval of any such application may be rescinded upon 90 days' notice to the bank affected.

B. ACCEPTANCE OF DRAFTS OR BILLS OF EXCHANGE DRAWN FOR THE PURPOSE OF CREATING DOLLAR EXCHANGE.

1 Statutory provisions.

Section 13 of the Federal Reserve Act also provides that any member bank may accept drafts or bills of exchange drawn upon it having not more than three months' sight to run, exclusive of days of grace, drawn, under regulations to be prescribed by the Federal Reserve Board, by banks or bankers in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange as required by the usages of trade in the respective countries, dependencies, or insular possessions.

No member bank shall accept such drafts or bills of exchange for any one bank to an amount exceeding in the aggregate 10 per centum of the paid-up and unimpaired
capital and surplus. This 50 per cent limit is separate and distinct from and not included in the limits placed upon the acceptance of drafts and bills of exchange as described under section A of this regulation.

11. Regulations.

Any member bank desiring to accept drafts drawn by banks or bankers in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange shall first make an application to the Federal Reserve Board setting forth the usages of trade in the respective countries, dependencies, or insular possessions in which such banks or bankers are located.

If the Federal Reserve Board should determine that the usages of trade in such countries, dependencies, or possessions require the granting of the acceptance facilities applied for, it will notify the applying bank of its approval and will also publish in the Federal Reserve Bulletin the name or names of those countries, dependencies or possessions in which banks or bankers are authorized to draw on member banks whose applications have been approved for the purpose of furnishing dollar exchange.

The Federal Reserve Board reserves the right to modify or on 90 days' notice to revoke its approval either as to any particular member bank or as to any foreign country or dependency or insular possession of the United States in which it has authorized banks or bankers to draw on member banks for the purpose of furnishing dollar exchange.
REGULATION D, SERIES OF 1920.

(Superseding Regulation D of 1917)

TIME DEPOSITS AND SAVINGS ACCOUNTS

Section 19 of the Federal Reserve Act provides, in part, as follows:

Demand deposits, within the meaning of this act, shall comprise all deposits payable within 30 days, and time deposits shall comprise all deposits payable after 30 days, and all savings accounts and certificates of deposit which are subject to not less than 30 days' notice before payment, and all postal savings deposits.

Time deposits, open accounts.

The term "time deposits, open accounts" shall be held to include all accounts, not evidenced by certificates of deposit or savings pass books, in respect to which a written contract is entered into with the depositor at the time the deposit is made that neither the whole nor any part of such deposit may be withdrawn by check or otherwise, except on a given date or on written notice which must be given by the depositor a certain specified number of days in advance, in no case less than 30 days.

Savings accounts.

The term "savings accounts" shall be held to include those accounts of the bank in respect to which, by its printed regulations, accepted by the depositor at the time the account is opened-

(a) The pass book, certificate, or other similar form of receipt must be presented to the bank whenever a deposit or withdrawal is made, and

(b) The depositor may at any time be required by the bank to give notice of an intended withdrawal not less than 30 days before a withdrawal is made.

Time certificates of deposit.

A "time certificate of deposit" is defined as
an instrument evidencing the deposit with a bank, either with or without interest, of a certain sum specified on the face of the certificate payable in whole or in part to the depositor or on his order-

(a) On a certain date, specified on the certificate, not less than 30 days after the date of the deposit, or

(b) After the lapse of a certain specified time subsequent to the date of the certificate, in no case less than 30 days, or

(c) Upon written notice, which the bank may at its option require to be given a certain specified number of days, not less than 30 days, before the date of repayment, and

(d) In all cases only upon presentation of the certificate at each withdrawal for proper indorsement or surrender.

REGULATION F, SERIES OF 1920.
(Superseding Regulation F of 1919)

TRUST POWERS OF NATIONAL BANKS

1 Statutory provisions.

The Federal Reserve Act as amended by the act of September 26, 1918, provides in part:

Sec. 11. The Federal Reserve Board shall be authorized and empowered:

(k) To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies or other corporations which
come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.

Whenever the laws of such State authorize or permit the exercise of any or all of the foregoing powers by State banks, trust companies, or other corporations which compete with national banks, the granting to and the exercise of such powers by national banks shall not be deemed to be in contravention of State or local law within the meaning of this act.

National banks exercising any or all of the powers enumerated in this subsection shall segregate all assets held in any fiduciary capacity from the general assets of the bank and shall keep a separate set of books and records showing in proper detail all transactions engaged in under authority of this subsection. Such books and records shall be open to inspection by the State authorities to the same extent as the books and records of corporations organized under State law which exercise fiduciary powers, but nothing in this act shall be construed as authorizing the State authorities to examine the books, records and assets of the national bank which are not held in trust under authority of this subsection.

No National bank shall receive in its trust department deposits of current funds subject to check or the deposit of checks, drafts, bills of exchange, or other items for collection or exchange purposes. Funds deposited or held in trust by the bank awaiting investment shall be carried in a separate account and shall not be used by the bank in the conduct of its business unless it shall first be set aside in the trust department United States bonds or other securities approved by the Federal Reserve Board.

In the event of the failure of such bank, the owners of the funds held in trust for investment shall have a lien on the bonds or other securities so set apart in addition to their claim against the estate of the bank.

Whenever the laws of a State require corporations acting in a fiduciary capacity to deposit securities with the State authorities for the protection of private or court trusts, national banks so acting shall be required to make similar deposits and securities so deposited shall be held for the protection of private or court trusts as provided by the State law.

National banks in such cases shall not be required to execute the bond usually required of individuals if State corporations under similar circumstances are ex-
empt from this requirement.
National banks shall have power to execute such bond when so required by the laws of the State.
In any case in which the laws of a State require that a corporation acting as trustee, executor, administrator or in any capacity specified in this section, shall take an oath or make an affidavit, the president, vice president, cashier or trust officer may take the necessary oath or execute the necessary affidavit.

It shall be unlawful for any national banking association to lend any officer, director, or employee any funds held in trust under the powers conferred by this section. Any officer, director, or employee making such loan, or to whom such loan is made, may be fined not more than $5,000, or imprisoned not more than five years, or may be both fined and imprisoned, in the discretion of the court.

In passing upon applications for permission to exercise the powers enumerated in this subsection, the Federal Reserve Board may take into consideration the amount of capital and surplus of the applying bank whether or not such capital and surplus is sufficient under the circumstances of the case, the needs of the community to be served, any and other facts and circumstances that seem to it proper and may grant or refuse the application accordingly: Provided, That no permit shall be issued to any national banking association having a capital and surplus less than the capital and surplus required by State law of State banks, trust companies and corporations exercising such powers.

11. Applications

A national bank desiring to exercise any or all of the powers authorized by section 11(k) of the Federal Reserve Act, as amended by the act of September 26, 1918, shall make application to the Federal Reserve Board, on a form approved by said Board, for a special permit authorizing it to exercise such powers. In the case of an original application—that is, where the applying bank has never been granted the right to exercise any of the powers authorized by section 11(k)—the application should be made on F.R.B. Form 61. In the case of a supplemental application—that is, where the applying bank has already been granted the right to exercise one or more of the powers authorized by section 11(k)—the application should be made on F.R.B. Form 61-b. Both forms are made a part of this regulation and may be obtained from the Federal
Reserve Board or any Federal Reserve Bank.

III. Separate departments

Every national bank permitted to act under this section shall establish a separate trust department, and shall place such department under the management of an officer or officers, whose duties shall be prescribed by the board of directors of the bank.

IV. Custody of trust securities and investments

The securities and investments held in each trust shall be kept separate and distinct from the securities owned by the bank and separate and distinct one from another. Trust securities and investments shall be placed in the joint custody of two or more officers or other employees designated by the board of directors of the bank and all such officers and employees shall be bonded.

V. Deposit of funds awaiting investment or distribution

Funds received or held in the trust department of a national bank awaiting investment or distribution may be deposited in the commercial department of the bank to the credit of the trust department, provided that the bank first delivers to the trust department, as collateral security, United States bonds or other readily marketable securities owned by the bank, which collateral security shall at all times be equal in market value to the amount of the funds so deposited.

VI. Investment of trust funds

(a) Private trusts.—Funds held in trust must be invested in strict accordance with the terms of the will, deed, or other instrument creating the trust. Where the instrument creating the trust contains provisions authorizing the bank, its officers, or its directors to exercise their discretion in the matter of investments, funds held in trust may be invested only in those classes of securities which are approved by the directors of the bank. Where the instrument creating the trust does not specify the character or class of investments to be made,
and does not expressly vest in the bank, its officers, or directors a discretion in the matter of investments, funds held in trust shall be invested in any securities in which corporate or individual fiduciaries in the State in which the bank is located may invest.

(b) Court trusts.—Except as hereinafter provided, a national bank acting as executor, administrator, or in any other fiduciary capacity, under appointment by a court of competent jurisdiction, shall make all investments under the order of that court, and copies of all such orders shall be filed and preserved with the records of the trust department of the bank. If the court by general order vests a discretion in the national bank to invest funds held in trust, or if the laws of the State in which the bank is located corporate fiduciaries appointed by the court are permitted to exercise such discretion, the national bank so appointed may invest such funds in any securities in which corporate or individual fiduciaries in the State in which the bank is located may lawfully invest.

VII. Books and accounts.

All books and records of the trust department shall be kept separate and distinct from other books and records of the bank. All accounts opened shall be so kept as to enable the national bank at any time to furnish information or reports required by the Federal or State authorities, and such books and records shall be open to the inspection of such authorities.

VIII. Examinations.

Examiners appointed by the Comptroller of the Currency or designated by the Federal Reserve Board will be instructed to make thorough and complete audits of the cash, securities, accounts, and investments of the trust department of the bank at the same time that examination is made of the banking department.

IX. Conformity with State laws.

Nothing in these regulations shall be construed to give a national bank exercising the powers permitted under the provisions of section 11(k) of the Federal Reserve Act, as amended, any rights or privileges in contravention
of the laws of the State in which the bank is located within the meaning of that act.

X. Revocation of permits.

The Federal Reserve Board reserves the right to revoke permits granted under the provisions of section 11(k), as amended, in any case where in the opinion of the Board a bank has wilfully violated the provisions of the Federal Reserve Act or of these regulations or the laws of any State relating to the operations of such bank when acting in any of the capacities permitted under the provisions of section 11(k) as amended.

XI. Changes in regulations.

These regulations are subject to change by the Federal Reserve Board; provided, however, that no such change shall prejudice any obligation undertaken in good faith under regulations in effect at the time the obligation was assumed.

REGULATION G, SERIES OF 1920.

(Superseding Regulation G of 1917)

LOANS ON FARM LAND AND OTHER REAL ESTATE

Section 24 of the Federal Reserve Act provides, in part, that-

Any national banking association not situated in a central reserve city may make loans secured by improved and unencumbered farm land situated within its Federal reserve district or within a radius of one hundred miles of the place in which such bank is located, irrespective of district lines, and may also make loans secured by improved and unencumbered real estate located within one hundred miles of the place in which such bank is located, irrespective of district lines; but no loan made upon the security of
such farm land shall be made for a longer time than five years, and no loan made upon the security of such real estate as distinguished from farm land shall be made for a longer time than one year, nor shall the amount of any such loan, whether upon such farm land or upon such real estate, exceed fifty per centum of the actual value of the property offered as security. Any such bank may make such loans, whether secured by such farm land or such real estate, in an aggregate sum equal to twenty-five per centum of its capital and surplus or one-third of its time deposits and such banks may continue hereafter as heretofore to receive time deposits and to pay interest on the same.

National banks not located in central reserve cities may, therefore, legally make loans secured by improved and unencumbered farm land or other real estate as provided by this section.

Certain conditions and restrictions must, however, be observed:

(a) There must be no prior lien on the land; that is, the lending bank must hold an absolute first mortgage or deed of trust.

(b) The amount of the loan must not exceed 50 per cent of the actual value of the land by which it is secured.

(c) The maximum amount of loans which a national bank may make on real estate, whether on farm land or on other real estate as distinguished from farm land, is limited under the terms of the act to an amount not in excess of one-third of its average time deposits during the preceding calendar year. Provided, however, that if one-third of such time deposits as of the date of making the loan or one-third of the average time deposits for the preceding calendar year is less than one-fourth of the capital and surplus of the bank as of the date of making the loan, the bank in such event shall have authority to make loans upon real estate under the terms of the act to the extent of one-fourth of the bank's capital and surplus as of that date.

(d) Farm land to be eligible as security for a loan by a national bank must be situated within the Federal reserve district in which such bank is located or within a radius of 100 miles of such bank irrespective of district lines.

(e) Real estate as distinguished from farm land to be eligible as security for a loan by a national bank must be located within a radius of 100 miles of such bank irrespective of district lines.
(f) The right of a national bank to "make loans" under section 24 includes the right to purchase or discount loans already made, as well as the right to make such loans in the first instance: Provided, however, That no loan secured by farm land shall have a maturity of more than five years from the date on which it was purchased or made by the national bank and that no loan secured by other real estate shall have a maturity of more than one year from such date.

(g) Though no national bank is authorized under the provisions of section 24 to make a loan on the security of real estate, other than farm land, for a period exceeding one year, nevertheless, at the end of the year, it may properly make a new loan upon the same security for a period not exceeding one year. The maturing note must be cancelled, and a new note taken in its place, but in order to obviate the necessity of making a new mortgage or deed of trust for each renewal, the original mortgage or deed of trust may be so drawn in the first instance as to cover possible future renewals of the original note. Under no circumstances, however, must the bank obligate itself in advance to make such a renewal. It must, in all cases, preserve the right to require payment at the end of the year and to foreclose the mortgage should that action become necessary. The same principles apply to loans of longer maturities secured by farm lands.

(h) In order that real estate loans held by a bank may be readily classified, a statement signed by the officers making a loan and having knowledge of the facts upon which it is based must be attached to each note secured by a first mortgage on the land by which the loan is secured, certifying in detail as of the date of the loan that all of the requirements of the law have been duly observed.

Regulation J, Series of 1920.

(Superseding Regulation J of 1917)

CHECK CLEARING AND COLLECTION

Section 16 of the Federal Reserve Act authorizes the Federal Reserve Board to require each Federal Reserve Bank to exercise the functions of a clearing house for its member banks, and section 17 of the Federal Reserve Act, as amended by the act approved June 21, 1917, authorizes
each Federal Reserve Bank to receive from any non-member bank or trust company for the purposes of exchange or collection, deposits of current funds, in lawful money, national bank notes, Federal Reserve notes, checks and drafts payable on presentation, or maturing notes and bills, provided such nonmember bank, or trust company maintains with its Federal Reserve Bank a balance sufficient to offset the items in transit held for its account by the Federal Reserve Bank.

In pursuance of the authority vested in it under these provisions of the law, the Federal Reserve Board, desiring to afford both to the public and to the various banks of the country a direct, expeditious and economical system of check collection and settlement of balances, has arranged to have each Federal Reserve Bank exercise the functions of a clearing house for such of its member banks to avail themselves of its privileges and for such nonmember State banks and trust companies as may maintain with the Federal Reserve Bank balances sufficient to qualify them under the provisions of section 13 to send items to Federal Reserve Banks for purposes of exchange or of collection. Such nonmember State banks and trust companies will hereinafter be referred to in this regulation as nonmember clearing banks.

Each Federal Reserve Bank shall exercise the functions of a clearing house under the following general terms and conditions:

(1) Each Federal Reserve Bank will receive at par from its member banks and from nonmember clearing banks in its district, checks drawn on all member and nonmember clearing banks and on all nonmember banks which agree to remit at par through the Federal Reserve Bank of their district.

(2) Each Federal Reserve Bank will receive at par from other Federal Reserve Banks, and from all member and nonmember clearing banks, regardless of their location, for the credit of their accounts with their respective Federal Reserve Banks, checks drawn upon all member and nonmember clearing banks of its district and upon all other nonmember banks of its district whose checks are collected at par by the Federal Reserve Bank.

(3) Immediate credit entry upon receipt subject to final payment will be made for all such items upon the books of the Federal Reserve Bank at full face value, but the proceeds will not be counted as part of the minimum reserve nor become available to meet checks drawn until such time as may be specified in the appropriate time schedule referred to in subdivision 7.

(4) Checks received by a Federal Reserve Bank on its member or nonmember clearing banks will be forwarded direct to such banks and will not be charged to their accounts until sufficient time has elapsed within which to receive advice of payment, as shown by the appropriate time schedule referred to in subdivision 7.
(5) Under this plan each Federal Reserve Bank will receive at par from its member and nonmember clearing banks checks on all member and nonmember clearing banks and on all nonmember banks whose checks can be collected at par by any Federal Reserve Bank. Member and nonmember clearing banks will be required by the Federal Reserve Board to provide funds to cover at par all checks received from or for the account of their Federal Reserve Banks: Provided, however, That a member or nonmember clearing bank may ship currency or specie from its own vaults at the expense of its Federal Reserve Bank to cover any deficiency which may arise because of and only in the case of inability to provide items to offset checks received from or for the account of its Federal Reserve Bank.

(6) Section 19 of the Federal Reserve Act provides that -
The required balance carried by a member bank with a Federal Reserve Bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities: Provided, however, That no bank shall at any time make new loans or shall pay any dividends unless and until the total balance required by law is fully restored.

Items can not be counted as part of the minimum reserve balance to be carried by a member bank with its Federal Reserve Bank until such time as may be specified in the appropriate time schedule referred to in subdivision 7. Therefore, should a member bank draw against items before such time, the draft would be charged against its reserve balance, if such balance were sufficient in amount to pay it; but any resulting impairment of reserve balances would be subject to all the penalties provided by the act.

Inasmuch as it is essential that the law in respect to the maintenance by member banks of the required minimum reserve balance shall be strictly complied with, the Federal Reserve Board, under authority vested in it by section 19 of the act, has prescribed as the basic penalty for any deficiency in reserve a sum equivalent to an interest on the amount of the deficiency of 2 per cent per annum above ninety-day discount rate of the Federal Reserve Bank of the district in which the member bank is located, and has announced that it will prescribe for any Federal Reserve district, upon the application of the Federal Reserve Bank of that district, as an additional progressive penalty for any subsequent deficiency by the same member bank during the same calendar year a sum equivalent to an interest charge on the amount of the subsequent deficiency at a rate increasing one-half of 1 per cent for each subsequent deficiency.

(7) Each Federal Reserve Bank will determine by analysis
the amounts appearing on its books to the credit of each member bank. Such analysis will show the true status of the reserve held by the Federal Reserve Bank for each member bank and will enable it to apply the penalty for impairment of reserve.

Each Federal Reserve Bank will publish time schedules showing the time at which any item sent to it will be counted as reserve and become available to meet any checks drawn.

(8) In handling items for member and nonmember clearing banks, a Federal Reserve Bank will act as agent only. The Board will require that each member and nonmember clearing bank authorize its Federal Reserve Bank to send checks for collection to banks on which checks are drawn, and, except for negligence, such Federal Reserve Bank will assume no liability. Any further requirements that the Board may deem necessary will be set forth by the Federal Reserve Banks in their letters of instruction to their member and nonmember clearing banks. Each Federal Reserve Bank will also promulgate rules and regulations governing the details of its operations as a clearing house, such rules and regulations to be binding upon all member and clearing member banks which are clearing through the Federal Reserve Bank.

REGULATION K, SERIES OF 1920.

(Superseding Regulation K of 1920, issued in March, 1920.)

BANKING CORPORATIONS AUTHORIZED TO DO FOREIGN BANKING BUSINESS UNDER THE TERMS OF SECTION 25(a) OF THE FEDERAL RESERVE ACT.

1. Organization

Any number of natural persons, not less in any case than five, may form a Corporation under the provisions of section 25(a) for the purpose of engaging in international or foreign banking or other international or foreign financial operations or in banking or other financial operations in a dependency or insular possession of the United States, either directly or through the agency, ownership, or control of local institutions in foreign countries or in such dependencies or insular possessions.

11. Articles of association.

Any persons desiring to organize a corporation for any of the purposes defined in section 25(a) shall enter into
articles of association (see F.R.B. Form 151 which is suggested as a satisfactory form of articles of association) which shall specify in general terms the objects for which the Corporation is formed, and may contain any other provisions not inconsistent with law which the Corporation may see fit to adopt for the regulation of its business and the conduct of its affairs. The articles of association shall be signed by each person intending to participate in the organization of the Corporation and when signed shall be forwarded to the Federal Reserve Board in whose office they shall be filed.

111. Organization certificate.

All of the persons signing the articles of association shall under their hands make an organization certificate on F.R.B. Form 152, which is made a part of this regulation, and which shall state specifically:

First. The name assumed by the Corporation

Second. The place or places where its operations are to be carried on.

Third. The place in the United States where its home office is to be located.

Fourth. The amount of its capital stock and the number of shares into which it shall be divided.

Fifth. The names and places of business or residence of persons executing the organization certificate and the number of shares to which each has subscribed.

Sixth. The fact that the certificate is made to enable the persons subscribing the same and all other persons, firms, companies and corporations who or which may thereafter subscribe to or purchase shares of the capital stock of such Corporation to avail themselves of the advantages of this section.

The persons signing the organization certificate shall acknowledge the execution thereof before a judge of some court of record or notary public who shall certify thereto under the seal of such court or notary. Thereafter the certificate shall be forwarded to the Federal Reserve Board to be filed in its office.

IV. Title.

Inasmuch as the name of the Corporation is subject to the approval of the Federal Reserve Board, a preliminary application for that approval should be filed with the Federal Reserve Board on F.R.B. Form 150, which is made a part of this regulation. This application should state merely that the organization of a Corporation under the proposed name is contemplated and may request the approval of that name and its
reservation for a period of 30 days. No Corporation which
issues its own bonds, debentures, or other such obligations
will be permitted to have the word "bank" as a part of its
title. No Corporation which has the word "Federal" in its title
will be permitted also to have the word "bank" as part of its
title. So far as possible, the title of the Corporation should
indicate the nature or reason of the business contemplated and
should in no case resemble the name of any other corporation
to the extent that it might result in misleading or deceiving
the public as to its identity, purpose, connections, or
affiliations.

V. Authority to commence business.

After the articles of association and organization certif-
cicate have been made and filed with the Federal Reserve Board,
and after they have been approved by the Federal Reserve Board
and a preliminary permit to begin business has been issued by
the Federal Reserve Board, the association shall become and be
a body corporate, but none of its powers except such as are
incidental and preliminary to its organization shall be ex-
ercised until it has been formally authorized by the Federal Re-
serve Board by a final permit generally to commence business.

Before the Federal Reserve Board will issue its final
permit to commence business, the president or cashier, together
with at least three of the directors, must certify (a) that
each director elected is a citizen of the United States; (b)
that a majority of the shares of stock is owned by citizens of
the United States, by corporations the controlling interest in
which is owned by citizens of the United States, chartered under
the laws of the United States, or by firms or companies, the con-
trolling interest in which is owned by citizens of the
United States; and (c) that of the authorized capital stock
specified in the articles of association at least 25 per cent
has been paid in in cash and that each shareholder has in-
dividually paid paid in in cash at least 25 per cent of his
stock subscription. Thereafter the cashier shall certify to
the payment of the remaining installments as an when each is
paid in in accordance with law.

VI. Capital stock.

No Corporation may be organized under the terms of section
25(a) with a capital stock of less than $2,000,000. The par
value of each share of stock shall be specified in the articles
of association, and no Corporation will be permitted to issue stock
of no par value. If there is more than one class of stock, the
name and amount of each class and the obligations, rights and
privileges attaching thereto shall be set forth fully in the
articles of association. Each class of stock shall be so
named as to indicate to the investor as nearly as possible what
is its character and to put him on notice of any unusual
attributes.

VII. Transfers of stock.

Section 25(a) provides in part that-

The majority of the shares of the capital stock of any such
corporation shall at all times be held and owned by the
citizens of the United States, by corporations the controlling
interest in which is owned by citizens of a State of the United
States, or by firms or companies the controlling interest in
which is owned by citizens of the United States.

In order to insure compliance at all times with the re­
quirements of this provision after the organization of the Cor­
poration, shares of stock shall be issuable and transferable only
on the books of the Corporation. Every application for the issue
or transfer of stock shall be accompanied by an affidavit of the
party to whom it is desired to issue or transfer stock, or by
his or its duly appointed agent, stating-

In the case of an individual.-(a) Whether he is or is not
a citizens of the United States, and if a citizen of the United
States, whether he is a natural born citizen or a citizen by
naturalization, and if naturalized, whether there is or is not
any arrangement under which he is to hold the shares or any of
the shares which he desires to have issued or transferred to him,
in trust for or in any way under the control of any foreign
state or any foreigner, foreign corporation, or any corporation
under foreign control, and if so, the nature thereof.

In the case of a corporation.-{a) Whether such corpor­
atation is or is not chartered under the laws of the United
States or of a State of the United States. If it is not, no
further declaration is necessary, but if it is, it must also
be stated (b) whether the controlling interest in such corpor­
atation is or is not owned by citizens of the United States and
(c) whether there is or is not any arrangement under which such
corporation will hold the shares or any of the shares if
issued or transferred to such corporation, in trust for or in
any way under the control of any foreign state or any foreigner,
or foreign corporation, or any corporation under foreign con­
trol, and if so, the nature thereof.

In the case of a firm or company.-{a) Whether the con­
trolling interest in such firm or company is or is not owned
by citizens of the United States and if so, (b) whether there is or is not any arrangement under which such firm or company will hold the shares or any of the shares if issued or transferred to such firm or company for or in any way under the control of any foreign state or any foreigner, or foreign corporation, or any corporation under foreign control, and if so, the nature thereof.

The board of directors of the Corporation, whether acting directly or through an agent, may, before making any issue or transfer of stock, require such further evidence as in their discretion they may think necessary in order to determine whether or not the issue or transfer of the stock would result in a violation of the law. No issue or transfer of stock which would cause 50 per cent or more of the total amount of stock issued or outstanding to be held contrary to the provisions of the law or these regulations shall be made upon the books of the Corporation. The decision of the Board of Directors in each case shall be final and conclusive and not subject to any question by any person, firm or corporation on any ground whatsoever.

If at any time by reason of the fact that the holder of any shares of the Corporation ceases to be a citizen of the United States, or, in the opinion of the board of directors, becomes subject to the control of any foreign state or foreigner or foreign corporation or corporation under foreign control, 50 per cent or more of the total amount of capital stock issued or outstanding is held contrary to the provisions of the law or these regulations, the board of directors may, when apprised of that fact, forthwith serve on the holder of the shares in question a notice in writing requiring such holder within two months to transfer such shares to a citizen of the United States, or to a firm, company or corporation approved by the board of directors as an eligible stockholder. When such notice has been given by the board of directors, the shares of stock so held shall cease to confer any vote until they have been transferred as required above, and if on the expiration of two months after such notice the shares shall not have been so transferred, the shares shall be forfeited to the Corporation.

The board of directors shall prescribe in the by-laws of the Corporation appropriate regulations for the registration of the shares of stock in accordance with the terms of the law and these regulations. The by-laws must also provide that the certificates of stock issued by the Corporation shall contain provisions sufficient to put the holder on notice of the terms of the law and the regulations of the Federal Reserve Board defining the limitations upon the rights of transfer.
VIII. Operations in the United States.

No Corporation shall carry on any part of its business in the United States, except such as shall be incidental to its international or foreign business. Agencies may be established in the United States with the approval of the Federal Reserve Board for specific purposes, but not generally to carry on the business of the Corporation.

IX. Investments in the stock of other corporations.

It is contemplated by the law that a Corporation shall conduct its business abroad either directly or indirectly through the ownership or control of corporations, and it is accordingly provided that a Corporation may invest in the stock of other certificates of ownership of any corporation organized:

(a) Under the provisions of section 25(a) of the Federal Reserve Act;
(b) Under the laws of any foreign country or a colony or dependency thereof;
(c) Under the laws of any State, dependency, or insular possession of the United States; provided, first, that such other corporation is not engaged in the general business of buying or selling goods, wares, merchandise, or commodities in the United States; and, second, that it is not transacting any business in the United States, except such as is incidental to its international or foreign business.

Except with the approval of the Federal Reserve Board, no Corporation shall invest an amount in excess of 15 per cent of its capital and surplus in the stock of any corporation engaged in the business of banking, or an amount in excess of 10 per cent of its capital and surplus in the stock of any other kind of corporation.

No corporation shall purchase any stock in any other corporation organized under the terms of section 25(a) or under the laws of any State, which is in substantial competition therewith, or which holds stock or certificates of ownership in corporations which are in substantial competition with the purchasing Corporation. This restriction, however, does not apply to corporations organized under foreign laws.

X. Branches.

No Corporation shall establish any branches except with
the approval of the Federal Reserve Board, and in no case shall any branch be established in the United States.

XI. Issue of debentures, bonds and promissory notes.

Approval of the Federal Reserve Board.—No Corporation shall make any public or private issue of its debenture bonds, notes or other such obligations without the approval of the Federal Reserve Board, but this restriction shall not apply to notes issued by the Corporation in borrowing from banks or bankers for temporary purposes not to exceed one year. The approval of the Federal Reserve Board will be based solely upon the right of the Corporation to make the issue under the terms of this regulation and shall not be understood in any way to imply that the Federal Reserve Board has approved or passed upon the merits of such obligations as an investment. The Federal Reserve Board will consider the general character and scope of the business of the Corporation in determining the amount of debentures, bonds, notes, or other such obligations of the Corporation which may be issued by it.

Application.—Every application for the approval of any such issue by a Corporation shall be accompanied by (1) a statement of the condition of the Corporation in such form and as of such date as the Federal Reserve Board may require; (2) a detailed list of the securities by which it is proposed to secure such issue, stating their maturities, indorsements, guaranties or collateral, if any, and in general terms the nature of the transactions or transactions upon which they were based; and (3) such other date as the Federal Reserve Board may from time to time require.

Advertisements.—No circular, letter, or other document advertising the issue of the obligations of a Corporation shall state or contain any reference to the fact that the Federal Reserve Board has granted its approval of the issue to which the advertisement relates. This requirement will be enforced strictly in order that there may be no possibility of the public's misconstruing such a reference to be an approval of the Federal Reserve Board of the merits or desirability of the obligations as an investment.

XII. Sale of foreign securities.

Approval of the Federal Reserve Board.—No Corporation
shall offer for sale any foreign securities with its indorsement or guaranty, except with the approval of the Federal Reserve Board, but such approval will be based solely upon the right of the Corporation to make such a sale under the terms of this regulation, and shall not be understood in any way to imply that the Federal Reserve Board has approved or passed upon the merits of such securities as an investment.

Application. - Every application for the approval of such sale shall be accompanied by a statement of the character and amount of the securities proposed to be sold, their indorsements, guaranties, or collateral, if any, and such other data as the Federal Reserve Board may from time to time require.

Advertisements. - No circular, letter, or other document advertising the sale of foreign securities by a Corporation with its indorsement or guaranty shall state or contain any reference to the fact that the Federal Reserve Board has granted its approval of the sale of the securities to which the advertisement relates.

VIII. Acceptances.

Kinds. - Any Corporation may accept (1) drafts and bills of exchange drawn upon it which grow out of transactions involving the importation or exportation of goods, and (2) drafts and bills of exchange which are drawn by banks or bankers located in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange as required by the usages of trade in such countries, dependencies, and possessions, provided, however, that, except with the approval of the Federal Reserve Board and subject to such limitations as it may prescribe, no Corporation shall exercise its power to accept drafts or bills of exchange if at the time such drafts or bills are presented for acceptance it has outstanding any debentures, bonds, notes, or other such obligations issued by it.

Maturity. - Except with the approval of the Federal Reserve Board, no Corporation shall accept any draft or bill of exchange which grows out of a transaction involving the importation or exportation of goods with a maturity in excess of six months, or shall accept any draft or bill of exchange drawn for the purpose of furnishing dollar exchange with a maturity in excess of three months.

Limitations. - (1) Individual drawers: No acceptances shall be made for the account of any one drawer in an amount aggregating at any time in excess of 10 per cent of the subscribed capital and surplus of the Corporation, unless the transaction be fully secured or represents an exportation or
importation of commodities and is guaranteed by a bank or banker of undoubted solvency. (2) Aggregates: Whenever the aggregate of acceptances outstanding at any time (a) exceeds the amount of the subscribed capital and surplus, 50 per cent of all the acceptances in excess of the amount shall be fully secured; or (b) exceeds twice the amount of the subscribed capital and surplus, all the acceptances outstanding in excess of such amount shall be fully secured. (The Corporation shall elect whichever requirement (a) or (b) calls for the smaller amount of secured acceptances.) In no event shall any Corporation have outstanding at any time acceptances drawn for the purpose of furnishing dollar exchange in an amount aggregating more than 50 per cent of its subscribed capital and surplus.

Reserves.- Against all acceptances outstanding which mature in 30 days or less a reserve of at least 15 per cent shall be maintained, and against all acceptances outstanding which mature in more than 30 days a reserve of at least 3 per cent shall be maintained. Reserves against acceptances must be in liquid assets of any or all of the following kinds: (1) cash; (2) balances with other banks; (3) bankers' acceptances; and (4) such securities as the Federal Reserve Board may from time to time permit.

XIV. Deposits.

In the United States.- No Corporation shall receive in the United States any deposits except as are incidental to or for the purpose of carrying out transactions in foreign countries or dependencies of the United States where the Corporation has established agencies, branches, correspondents, or where it operates through the ownership or control of subsidiary corporations. Deposits of this character may be made by individuals, firms, banks, or other corporations, whether foreign or domestic, and may be time deposits or on demand.

Outside of the United States.- Outside the United States a Corporation may receive deposits of any kind from individuals, firms, banks, or other corporations: Provided, however, that if such Corporation has any of its bonds, debentures, or other such obligations outstanding it may receive abroad only such deposits as are incidental to the conduct of its exchange, discount, or loan operations.

Reserves.- Against all deposits received in the United States reserve of not less than 15 per cent must be maintained. This reserve may consist of cash in vault, a balance with the Federal Reserve Bank of the district in which
the head office of the Corporation is located, or a balance with any member bank. Against all deposits received abroad the Corporation shall maintain such reserves as may be required by local laws and by the dictates of sound business judgment and banking principles.

XV. General limitations and restrictions.

Liabilities of one borrower.—The total liabilities to a Corporation of any person, company, firm or corporation for money borrowed, including in the liabilities of a company or firm the liabilities of the several members thereof, shall at no time exceed 10 per cent of the amount of its subscribed capital and surplus, except with the approval of the Federal Reserve Board: Provided, however, That the discount of bills of exchange drawn in good faith against actually existing values and the discount of commercial or business paper actually owned by the person negotiating the same shall not be considered as money borrowed within the meaning of this paragraph. The liability of a customer on account of an acceptance made by the Corporation for his account is not a liability for money borrowed within the meaning of this paragraph unless and until he fails to place the Corporation in funds to cover the payment of the acceptances at maturity or unless the Corporation itself holds the acceptance.

Aggregate liabilities of the Corporation.—The aggregate of the Corporation's liabilities outstanding on account of acceptances, average domestic and foreign deposits, debentures, bonds, notes, guaranties, indorsements, and other such obligations shall not exceed at any one time ten times the amount of the Corporation's subscribed capital and surplus except with the approval of the Federal Reserve Board. In determining the amount of the liabilities within the meaning of this paragraph, indorsements of bills of exchange having not more than six months to run, drawn, and accepted by others than the Corporation, shall not be included.

Operations abroad.—Except as otherwise provided in the law and these regulations, a Corporation may exercise abroad not only the powers specifically set forth in the law, but also such incidental powers as may be used in the determination of the Federal Reserve Board in connection with the transaction of the business of banking or other financial operations in the countries in which it shall transact business. In the exercise of any of these powers abroad a Corporation must be guided by the laws of the country in which it is operating and by sound business judgment and banking principles.
The directors, officers, or employees of a Corporation shall exercise their rights and perform their duties as directors, officers, or employees, with due regard to both the letter and spirit of the law and these regulations. For the purpose of these regulations the Corporation shall, of course, be responsible for all acts of omission or commission of any of its directors, officers, employees, or representatives in the conduct of their official duties. The character of the management of a Corporation and its general attitude toward the purpose and spirit of the law and these regulations will be considered by the Federal Reserve Board in acting upon any application made under the terms of these regulations.

XVII. Reports and examinations.

Reports. - Each Corporation shall make at least two reports annually to the Federal Reserve Board at such times and in such form as it may require.

Examinations. - Each Corporation shall be examined at least once a year by examiners appointed by the Federal Reserve Board. The cost of examinations shall be paid by the Corporation examined.

XVIII. Amendments to regulations.

These regulations are subject to amendment by the Federal Reserve Board from time to time: Provided, however, that no such amendment shall prejudice obligations undertaken in good faith under regulations in effect at the time they were assumed.

Regulations under which national banks may act as insurance agents and as brokers or agents in making or procuring loans on real estate under the amendment covering such action passed by Congress in 1916 as issued from the office of the Comptroller of the Currency:

Where a National Bank Acts as Insurance Agent.

(a) The bank must be located in a place the population
of which does not exceed 5,000 as shown by the last preceding decennial census.

(b) The insurance company for which the bank acts as agent must have been authorized by the authorities of the State in which the bank is located to do business in that State.

(c) The activities of the bank as such agent must be restricted to the soliciting and selling of insurance and the collection of premiums on policies issued by the insurance company.

(d) The bank may receive for services so rendered such lawful fees or commissions as may be agreed upon between the bank and the insurance company for which it may act as agent.

(e) The bank is prohibited from assuming or guaranteeing the payment of any premium on insurance policies issued, through its agency, by its principal.

(f) The bank is prohibited from guaranteeing the truth of any statement made by an assured in filing his application for insurance.

(g) The powers conferred are to be exercised under such regulations as may be prescribed by the Comptroller of the Currency.

In pursuance of the foregoing amendment the following regulations are hereby prescribed for national banks which may undertake to act as agents for insurance companies.

1. Each contract of agency must be formally accepted by the board of directors of the agent bank by a resolution spread upon the minutes in the following form.

"Be it resolved that the contract of agency entered into on 191___ between the _______ insurance company and the _______ national bank of _______ by _______ president (or vice president) and _______ cashier, a copy of which is on file in this bank, is hereby ratified and approved."

2. A certified copy of such resolution, attested by the president or vice president and by the cashier and by a majority of the directors of the bank, must be forwarded to this office on forms to be furnished by this office.

3. There should be on file in the bank, available for inspection by the examiner, the following documents:

(a) An authoritative statement showing the population of the town according to the last preceding decennial census.

(b) A proper certificate from the authorities of the State in which the bank is located showing as to each insurance company for which the bank is acting as agent that such company has received authority from the said State to transact business in that State.

(c) A proper certificate or other writing of each insur-
urance company for which the bank acts authorizing the bank to act as its agent, setting forth that the bank does not guarantee the payment of any premium on insurance policies issued through its agency by its principal, and stating that the bank is not to be held responsible for the truth of any statement made by an assured in filing his application for insurance.

(d) Copies of all reports made by the agent bank to each insurance company which it represents.

4. The bank will be required to keep a record as to each company for which it acts as agent, showing: For fire insurance: The amount of each policy, the rate and premium, date of commencement, term and date of expiration, as well as a description of property insured, with name of assured and to whom loss is payable. As to life insurance: Amount and date of policy, with premium, and a statement as to under what form the insurance is written, giving also name of assured and beneficiary. As to any and all other forms of insurance: The fullest possible particulars as to amounts, dates, rates, premiums, and what is insured by the policy, and of collection of all premiums collected for account of the company, refunds made, the proportion of premium credited to the profits of the bank under its agreement with the company, the proportion due the company, the amounts and dates of all remittances made to the insurance company on account of premiums collected, and the balance, if any, due from the bank to the insurance company.

5. The bank will be required to carry on its general ledger an account which will, at all times, show the amount due to insurance companies for which it is acting as agent, on account of premiums collected, but not remitted, and the liability must be shown in reports of condition and in the published statements of the bank under the heading "Other liabilities- on account of insurance premiums collected and not remitted," unless specifically provided for in the report.

6. The bank should also keep such records as may be required by each insurance company in the manner and under the forms prescribed by the various companies; all of which should be available for inspection by the examiner on request.

7. The agent bank must not assume any responsibility or liability for either the adjustment, settlement, or payment of losses under any policy issued by or through its agency.

8. The records of all profits derived from the insurance agency should be carried in a separate account on the books of the bank, and the records should be so kept as to enable
the examiner readily to trace to the source all items of profit derived in this connection.

Where a National Bank Acts as Broker or Agent in Making or Procuring Loans on Real Estate

In order to avail itself of this privilege:

(a) The bank must be located in a place the population of which does not exceed 5,000 as shown by the last preceding decennial census.

(b) The real estate by which the loans negotiated are secured must be located within 100 miles of the place in which the negotiating bank is located.

(c) The bank may receive for such services a reasonable fee or commission.

(d) The bank shall in no case guarantee either the principal or interest of any such loans.

(e) The powers conferred are to be exercised under such regulations as may be prescribed by the Comptroller of the Currency.

The following regulations are prescribed for national banks which may undertake to act as agents or brokers in making or procuring loans on real estate.

1. A bank intending to avail itself of this provision of the law must adopt by its board of directors a resolution in the following form:

"Be it resolved, That the officers of the [Name of Bank] are hereby authorized and empowered on behalf of this bank, as broker or agent, to accept from customers of this bank deposits of funds to be invested for account of said customers, in loans secured by real estate, and to procure, as broker or agent, for customers of this bank loans which shall be secured by real estate, under the provisions of the act approved September 7, 1916: Provided, That the investment of such funds as stated, and all such procuring of loans or lending of funds for clients shall be undertaken only under written instructions from the customer for whom the bank, through its officers, may act as broker or agent, such written instructions in each case to be first delivered to an officer of this bank. Such instructions shall, in all cases, state clearly that the bank in acting as broker or agent in no way guarantees payment of either the principal or interest of any loan so negotiated."

2. A certified copy of such resolution, attested by the president or vice president and cashier, and by a
majority of the directors of the bank, must be forwarded to this office, on forms to be furnished by this office.

3. No bank shall charge more than one commission or brokerage on the making of any loan; that is to say, if it shall charge a brokerage or commission to the party borrowing the money, it shall not charge a brokerage or commission to the party for whom the money is loaned, and vice versa.

4. Each bank acting under this provision of law will be required to keep a record showing as to each loan negotiated by the bank:
   (a) The name and address of the principal for whom the bank is acting,
   (b) Date of written instructions from the principal,
   (c) Name and address of maker of note,
   (d) Date of note,
   (e) Date of maturity of note,
   (f) Brief description of property securing note, showing location and distance from place in which bank is located,
   (g) Character or improvements, etc.,
   (h) Name and address of party to whom note was transferred or delivered by the bank,
   (i) Date of such transfer or delivery,
   (j) Amount of principal of note,
   (k) Rate or interest or discount,
   (l) Rate of commission or brokerage charged by bank for acting as broker or agent, and
   (m) Amount of such commission or brokerage, and whether said commission was paid by borrower of the money or by the party for whom it was loaned.

5. A book should be kept showing the date on which each mortgage or deed or trust negotiated by the bank has been admitted to record, the court in which the same is recorded, and the recordation fees paid in each case.

6. The records of all profits derived from acting as broker or agent in negotiating loans on real estate should be carried in a separate account on the books of the bank, and the records should be so kept as to enable the examiner readily to trace to the source all items of profit derived in this connection.

7. Deposits of money received by the bank as broker or agent to be invested in loans secured by real estate as prescribed by law, must be treated as trust funds and kept separate and apart from the other assets of the bank. Such funds must in no case be permitted to pass from the possession of the bank until the loan for which they are to be paid
out is formally accepted by or in behalf of the party for whose account negotiated.

8. No bank shall advance or use its own funds in connection with real estate loans negotiated as broker or agent.

9. No loans secured by real estate, which the bank has negotiated as broker or agent, should become a part of the assets of the bank even temporarily, unless such loans conform to the provisions of section 24 of the Federal Reserve Act, as amended.

10. There should be available in the bank for inspection by the national bank examiner:

(a) An authoritative statement showing the population of the town according to the last preceding decennial census.
(b) All records pertaining to the negotiation of real estate loans as broker or agent.

National banks acting as broker for the placing of loans should prepare blank forms of application to be executed by applicants for loans. These applications should show:

(a) Location of property.
(b) Acreage.
(c) Assessed valuation.
(d) Estimated present value.
(e) Brief descriptions of buildings thereon and estimated value of them.
(f) Whether buildings are insured, and if so, for what amounts and in what companies.
(g) Whether property is already encumbered and, if so, for what amount.
(h) If property is farm property, applicant should state whether or not the dwelling is provided with sanitary arrangements approved by the local board of health, and, if not, what sanitary arrangements there are.

At the foot of this application should be printed below the signature of the applicant a statement to the effect that "The statements in the foregoing application have been submitted to this bank by the applicant for the loan, but the bank does not undertake to guarantee the correctness of any of the statements made by the applicant."

If any application for a loan makes statements in his application which any officers of the bank before whom the application may come may have reason to think are not correct, the attention of the applicant should be called to the possible discrepancy.
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