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Noted
BJ

July 2, 1943

MEMORANDUM

The question has been raised whether the Federal Reserve banks acting in their individual capacity, as distinguished from their capacity as fiscal agents of the United States, could discount notes, drafts, and bills of exchange for the proposed International Stabilization Fund.

The authority of the Federal Reserve banks to discount obligations is derived principally from U.S.C. title 12, sec. 343, and is circumscribed with limitations which would seriously hamper any efforts to discount obligations of the proposed International Stabilization Fund. The transactions are authorized only if all of the following conditions are met:

(1) The instruments must arise out of "actual commercial transactions", i.e. notes, drafts, and bills of exchange issued or drawn for agricultural, industrial or commercial purposes or the proceeds of which have been used or are to be used for such purposes. The Board of Governors determines or defines the character of the paper thus eligible for discount. (Notes, drafts, or bills covering merely investments or issued for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States, are expressly excluded.)

(2) The paper must be endorsed by a member bank.

(3) The paper must have a maturity, at the time of discount, of not more than 90 days.

In addition to direct discounts, there is statutory authority for making purchases and sales. Federal Reserve banks may purchase and sell in the open market, at home or abroad, from or to domestic or foreign banks, firms, corporations, or individuals, bills of exchange of the kinds and maturities made eligible for rediscount, with or without the endorsement of a member bank (U.S.C. title 12, sec. 353). Assuming the Fund were able to discount its obligations elsewhere in the first instance, the Federal Reserve banks could purchase such obligations in the open market provided they were of the type which would be eligible for rediscount (i.e. those arising out of actual commercial transactions).

A third source of authority which may be considered is found in U.S.C. title 12, sec. 358. Federal Reserve banks are given authority to maintain accounts in foreign countries, appoint correspondents and establish agencies for the purpose of purchasing, selling, and collecting bills of exchange and to buy and sell through them, with or without its endorsement, bills of exchange (or acceptances) arising out of actual commercial transactions which have not more than 90 days to run. In this connection it should be noted that the Board of Governors is directed to supervise all relations and transactions between Federal Reserve banks and foreign banks or groups of banks and all negotiations must be conducted with the permission of the board (U.S.C. title 12, sec. 348(a)).

Bearing in mind the nature of the paper the Fund is likely to desire to have discounted, it would seem that under the present provisions of the Act of December 23, 1913, as amended, the Federal Reserve banks' limited ability to discount would not prove too helpful.

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