

REPORT
OF
FEDERAL RESERVE COMMITTEE ON ACCEPTANCE PRACTICE

November 6, 1936.

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REPORT OF THE FEDERAL RESERVE SYSTEM COMMITTEE
ON ACCEPTANCE PRACTICE

During the spring of 1932 a committee of the Federal Reserve System began a study of phases of acceptance practice which had grown up under the Federal Reserve Act. The project was initiated by a letter of May 6, 1932, from Mr. Eugene Meyer, then Governor of the Federal Reserve Board, to Mr. J. U. Calkins, Chairman of the Governors Conference of the Federal Reserve System. The completion of this report has been delayed in order that a review might be made of the experience of American acceptors in connection with the standstill arrangements made with central European countries in 1931. It was not until the end of 1935 that the final results of this experience were becoming sufficiently obvious to make possible an assessment of it. A summary of the standstill experience appears hereafter in this report but a more complete and detailed analysis has been prepared and is attached herewith as a supplementary report.

Terms of Reference. - Mr. Meyer's letter, referred to above, was as follows:

"Certain phases of the acceptance practice which has grown up under the Federal Reserve Act have been made the subject of comment in recent years and occasionally of criticism. The report which was submitted on behalf of the Committee on Banking and Currency of the Senate, regarding S. 4412, devotes a paragraph to 'The Growth of Acceptance Credit,' which contains a number of such criticisms. The Board feels that certain of these criticisms may have pertinency and that it would be helpful to make a thorough and discriminating study of American acceptance practice and its development, particularly as influenced by the more liberal attitude adopted by the Federal Reserve System in recent years and reflected both in the rulings and regulations of the Federal Reserve Board and in the operating practices of the Federal reserve banks. The Board, therefore, suggests that a committee be set up to begin an investigation at an appropriate time along the lines indicated and to make recommendations for such correction of procedure and/or revision of the Board's rulings and regulations, as may be found to be necessary or desirable. Such a committee might be either a committee of the Federal reserve banks alone or a joint committee representing both the banks and the Board. It would be appreciated if you would consider this matter and let the Board have the benefit of your suggestions, made after consultation with the Governors of other Federal reserve banks if you prefer, including your views as to the personnel of such a committee, so far as it involves representation of the Federal reserve banks."

Typical Criticism of Acceptance Practice. - The paragraphs on "The Growth of Acceptance Credit" contained in the report of the Committee on Banking and Currency of the Senate on S. 4412, referred to in Governor Meyer's letter, were as follows:

"The Growth of Acceptance Credit"

"The general ease and accessibility of credit under the regime which existed prior to 1929 was accentuated by the issue of the instrument known as the bankers' acceptance. In its original purpose this form of lending was intended to include only unquestionably liquid obligations, growing out of the actual sale of goods in foreign trade, so that the acceptance became a short-term claim payable in international funds, usually gold. It was this conception of the instrument which was originally adopted in the Federal reserve act, and on which the use of the instrument by the Federal reserve system was founded. Later amendments to the reserve act, adopted during the World War, broadened the use of the acceptance and opened the door to the application of a conception of its use which was practically that of a finance bill--a bill drawn without reference to the immediately liquid character of a given transaction, and primarily based upon the general power of the parties to it to see that it was liquidated from some source. The use of the acceptance to supply what was called dollar exchange, although doubtless of advantage under proper restrictions, undoubtedly opened a door to grave abuses, which were in some measure responsible for the credit difficulties that later made their appearance in South American finance. These difficulties, however, were after all comparatively minor, the real dangers of the acceptance being exhibited in connection with the stretching of the definition of various transactions so as, for instance, to include storage of commodities as an incident to their moving abroad or moving from one market to another so that acceptances protected by such stored goods were regarded as acceptances made against goods actually moving in international trade. It was easy to pass from this view of the situation to another and more advanced view, wherein stored goods not sold during the period of the acceptance were used as goods properly providing a basis for renewal of the acceptance so that revolving acceptances or acceptances growing out of revolving credits became common, notwithstanding official warnings against them.

"From the domestic standpoint, it would seem clear that not a few banks had fallen into the habit of supplying their customers with funds through the issue and sale of their acceptances, without much regard to the question whether such acceptances were called for or not. That the large amount of reserve credit thus created prevented effective control of security loans and investments of the banks, and thus fostered the stock market boom, there can be little doubt.

"Through these and similar means, too, a very large commitment on the part of American banks taken on behalf of foreign banks came into existence. Germany, in particular, proved to be a great borrower on this score, and the total of acceptances made directly or indirectly in order to provide funds for foreign banks grew to unprecedented amounts. The effect of these transactions upon the German banks themselves, in leading

up to the German financial collapse of July, 1931, has been carefully traced by the international committee of bankers which met under the chairmanship of Mr. A. H. Wiggin in Basle, after the breakdown of Germany during the past summer, for the purpose of discussing ways and means of dealing with the German credit situation."

Membership of the Committee. - In line with Governor Meyer's letter the Committee appointed included Mr. E. R. Kenzel, Chairman, Mr. C. R. McKay, and Mr. Ira Clerk, Deputy Governors respectively of the Federal Reserve Banks of New York, Chicago, and San Francisco. It was determined by the Federal Reserve Board that its representation on the Committee should be through its senior staff, and Mr. W. W. Riefler, of the Division of Research and Statistics of the Federal Reserve Board, was detailed to assist in the formulation of the procedure for collecting and analyzing information regarding acceptance practice as it has grown up under the Federal Reserve Act. Mr. Riefler was succeeded in this assignment by Mr. G. W. Blattner of the same division.

At the time the material collected by your Committee was being organized for this report, the untimely death of its chairman occurred, and on October 14, 1933, Mr. W. Randolph Burgess, Deputy Governor of the Federal Reserve Bank of New York, was appointed to the chairmanship of the Committee. Mr. C. R. McKay retired from the Committee in September, 1936, simultaneously with his resignation from the Federal Reserve Bank of Chicago. But before his retirement he reviewed a draft of this report and gave the Committee the benefit of his suggestions. The report has also been submitted to, and comments have been received from, the other members of the subcommittee of the general committee on bankers acceptances, Mr. W. W. Paddock, first vice president of the Federal Reserve Bank of Boston, and Mr. F. J. Zurlinden, first vice president of the Federal Reserve Bank of Cleveland.

Formulation of Method of Analysis. - It was apparent at the outset that acceptance practice as it has grown up under the Federal Reserve Act has several different aspects. One of these is the soundness and safety of the business of accepting institutions as it has developed under the influence of the regulations of the Board with respect to the technical eligibility of bills for acceptance by

member banks and the eligibility of accepted bills for purchase or discount by Federal reserve banks. Another aspect relates broadly to the development of the acceptance market and the influence of the Federal Reserve System in that development. Features of this aspect include such matters as the development of the prime accepting names in the central markets, the breadth of the market for acceptances, the rate policy pursued by the Federal Reserve System in taking open-market offerings of acceptances, the effect of the operations of the Federal reserve banks in acting as agent for foreign purchasers in acquiring American acceptances for investment, and other related matters.

Questionnaire of Senate Committee. - During the course of the investigations conducted by the Committee on Banking and Currency of the Senate in drafting the legislation which ultimately was enacted as the Banking Act of 1933, a questionnaire dealing with acceptance practice was directed to all Federal reserve banks, the result of which is included as an appendix, Part VI, of the published hearings held by the Senate Committee. The questionnaire contained 33 questions, most of which related to the second broad problem of acceptance practice, having to do more with the effect of Federal Reserve System policy on the development of the market for acceptances and less to do with unsound practices of acceptors growing out of technical regulations of eligibility. In sending out its questionnaire, the investigators for the Senate Committee used the following preface:

"Federal reserve officials have called attention to the fact that, at times, the dependence of the acceptance market on the reserve banks has interfered with the credit policies in force at the moment. The purpose of these questions is to inquire into the nature of and the extent of the dependence of the acceptance market on the reserve banks and the relationship between the volume of acceptance purchases by the reserve banks and the expansion and contraction of credit."

Your Committee considered the material compiled for the use of the Senate Committee, and concluded that the most productive and most fundamental approach to the whole problem would be to explore the experience of accepting institutions

with respect to the soundness and safety of their accepting business as it has developed under the influence of the regulations of the Board.

A Statistical Analysis. - Your Committee took under consideration various plans for approaching this problem and consulted with leading acceptors. As a result, a statistical project was planned "to obtain data regarding acceptance practices for the purpose of formulating recommendations for changes in the law or the Board's regulations if such changes are shown by the study to be desirable." This project was addressed to the first of the broad problems of acceptance practice described above, and the results of this limited investigation form the subject matter of the present report and its recommendations.

In general, the plan for approaching the problem of acceptance practice, that is the soundness of the business conducted by acceptors, entailed requesting each organization which had been an important acceptor in the past decade for detailed information with respect to every credit "on which the bank's customer failed promptly to meet obligation to place the accepting bank in possession of funds to pay the acceptance." (Seven different styles of schedules were contrived, one for each of the following classes of credits:

- I. Import credit
- II. Export credit
- III. Domestic shipment credit
- IV. Credit covering shipments between foreign countries
- V. Domestic storage credit
- VI. Foreign storage credit
- VII. Dollar exchange credit

There is bound following this page as an exhibit the questionnaire used with respect to import credits. A similar body of information was requested with respect to credits falling in the other six classifications. These seven classifications, in which acceptances are naturally grouped on the basis of the style of underlying transaction, were suggested by the development of the law and regulations and are recognized in the main by the statistics currently compiled by the American Acceptance Council. The Council, however, in reporting acceptances outstanding from time to time includes in one grouping shipment between or storage in foreign countries.

1. Import Credit

Data regarding import acceptance credit on which the bank's customer failed promptly to meet obligation to place the accepting bank in possession of funds to pay the acceptance.

A. Name of Accepting Bank

Address

Federal reserve district

B. Amount of bill or bills:

C. Terms of bill or bills:

- | | |
|-------------------|----------------------|
| 1. Date drawn: | 2. Usance: |
| 3. Date accepted: | 4. Date of maturity: |

D. Underlying transaction:

- | | |
|---------------|-----------------------|
| 1. Commodity: | 2. Country of origin: |
|---------------|-----------------------|
3. Date of shipment:
 4. Was it drawn after the physical import of the commodity was completed?
 5. Did you receive shipping documents?
 6. If not, what other evidence did you receive of a bona fide import?
(Please specify)
 7. Was the credit secured?
 8. What was the security?
 9. Was the term of the bill based upon the period usually required for shipment or on the usual credit terms obtaining in the trade concerned?
(Please specify)
 10. Was it a renewal bill?
 11. Was the taker of credit the importer?
 12. If not, what was the relation of the taker of credit to the goods?

E. Disposition of the goods:

1. What disposition was made of the goods?
2. Did you release them on trust receipts?

F. How was the credit opened under which the bill was drawn?

1. Was it negotiated at your head office, through a branch, representative, correspondent bank or other agent? (Please specify)
2. Was it a letter of credit or acceptance agreement? (Please specify)
3. Did it cover this one import only or was it a revolving, general or syndicate credit? (Please specify)
4. Please state briefly any other pertinent details showing the general type of the credit:

1. Import Credit (continued)

G. What was your experience with this bill after its maturity?

1. Was renewal granted?
2. Was the credit eventually paid?
3. Did you absorb a loss? If so, how much?
4. Or is the matter still in suspense?

REMARKS: Please describe any additional facts or circumstances which are necessary to give a clear picture of the transaction and the reasons why the customer failed to place you in funds to meet the bill at maturity:

Distribution of Questionnaires Through Federal Reserve Banks. - Under

date of December 8, 1932, a letter signed by the chairman was directed by your Committee to the Governor of each Federal reserve bank, transmitting a supply of the questionnaires to be distributed among important accepting institutions. The letter stated:

"With regard to the study of the development of the acceptance business in this country to be undertaken by a committee of the Governors' Conference in conjunction with the Federal Reserve Board, as reported to and discussed at the recent Governors' Conference, I have pleasure in outlining the method of procedure adopted by the committee in conference with our friends at Washington.

"It was believed that the most desirable machinery for collecting data and information would be the Federal reserve banks whose close contacts with the accepting institutions in their respective districts would result in more frank discussions of their individual problems, and that the respective reserve banks would be more effective each in its own district in gathering the worth while views on the larger and more general subjects of the study than any other agency.

"Accordingly, two forms of letters have been prepared which it is proposed to ask the governors of the several reserve banks to address to institutions in their districts which are or have been actively interested in granting bankers' acceptance credit. You will note, from the drafts of these letters which I enclose herewith, that from the active and also inactive acceptors we asked first for a statement of their views in the light of their experience as accepting bankers as to desirable changes either in the law or in the regulations, and that they give reasons, examples and their experiences upon which they based their views and recommendations." . . .

"As to the banks to be addressed by either form of letter, a preliminary study of the bills bought by the New York bank for System account during the past 18 years revealed that there had been many changes in the names appearing in the New York market. These changes resulted largely from consolidations and liquidations; also, some names which in past years appeared either frequently or in relatively considerable volume have not been seen in recent years. As a result of that study the enclosed list of accepting institutions in your district was prepared as possible subjects for inquiry, but the committee realizes that you are in much better position than any other body to judge in that regard and so please consider this list of acceptors in your district merely as suggestions on the part of the committee whose general view has been that probably more satisfactory results could be obtained by a general limitation of inquiries to institutions either important as acceptors or for the views of whose officers you would have a high regard."

The letter which was proposed by the Committee for the use of the Governors in addressing active accepting institutions in their respective districts stated that in reviewing the experience of American institutions in granting acceptance credits

" . . . it would be helpful to the Federal reserve banks and the Federal Reserve Board to have certain data and to draw upon the experience of accepting bankers for suggestions as to desirable changes either in the law or in the regulations.

"Therefore, it will be appreciated if you will

"(a) state your views on this subject and give reasons and examples in support of any changes which in the light of your experience you think should be made in either the law or the regulations.

"(b) indicate the extent to which each of the different categories of your acceptance business may have been affected in recent years by foreign monetary disturbances, and other difficulties you may have experienced by reason of laws of foreign countries.

"In addition to the above general comments it is desired for the purpose of this study also to collect data relating to individual acceptance credits which for one reason or another have resulted in losses or otherwise proved unsatisfactory. We are therefore enclosing various specimen forms showing the information desired from you regarding such credits. It is not desired, however, that these reports be filled out for credits where the only difficulty was a slight delay in receipt of remittance, or for credits the maturities of which have been prolonged solely because of standstill or other similar country-wide restrictions. But in such cases it would be helpful for the purpose of this study if total figures for all credits coming within such restrictions might be furnished."

The letter directed to institutions which had become less active as acceptors, or had ceased to accept, was substantially the same as the letter addressed to active acceptors except that the inactive ones were asked to outline the experience which led them to curtail their acceptance activities,

Assembly of Replies to Questionnaires. - During the early part of 1933 the replies of the accepting banks were assembled, although there were delays associated with the strenuous duties demanded of bankers of all sorts during these months. Thus, this report does not include experience with any credits originating subsequent to 1932.

On April 19 and October 10, 1933, your Committee made interim reports to the Governors Conferences while the material made available by the questionnaires was being analyzed. The second report stated:

"The replies received since the last Governors Conference do not differ materially from the earlier replies and confirm the opinion already held by the majority of those who have been in closest touch with the development of the acceptance practice in this country that on the whole the experience of accepting banks has been unusually satisfactory and that the existing law and regulations governing the granting of acceptance credits are suitable for the proper conduct of the acceptance business. The facts brought out in this survey would appear to indicate that in general, errors of credit judgment, falling prices and reduced business morality, which is always evident in periods of economic disorder, were responsible for the great majority of losses and unsatisfactory experience incurred by accepting banks rather than any defect in existing law or regulations. Suggestions and comments are still chiefly confined to three categories:

1. That with regard to financing movements of goods between foreign countries the basis should be more clearly defined to the end that accepting banks would be required to know the details of underlying transactions and be assured of a reasonable expectation that the underlying transaction would produce the funds to retire the bills at their maturity.

2. That the law and regulations as to domestic shipments are too rigid and should be amended to permit acceptances to be made against the domestic shipments of goods under straight bills of lading or other shipping documents not necessarily conveying security title.

3. Some criticism of the functioning of the discount market and alleged discrimination in the market against bills of certain institutions located both in the interior and in New York City."

Owing to the press of other matters following the banking holiday, and the desire to include as complete a study of experience with the so-called standstill agreements as was possible, the preparation of your Committee's final report has been delayed until now. This delay served an additionally useful purpose since it has permitted the completion of the study of a number of important cases, final settlement of which was still in suspense at the time the original questionnaires were submitted in 1933.

Replies to Questionnaires. - The various Federal reserve banks requested reports on questionnaires from 170 accepting institutions, distributed among

Federal reserve districts as follows:

District 1	17	District 7	11
2	41	8	6
3	9	9	5
4	13	10	13
5	14	11	8
6	15	12	18

All districts 170

Responses were received from 156 banks in all, although 116 banks did not fill out any questionnaires since they had encountered no unfavorable experience.

One or more unsatisfactory credits were reported by each of 40 institutions, 31 being member banks. Actual losses were reported by only 24 banks. In all, 188 cases of credits upon which some difficulty was experienced were reported. These cases of unsatisfactory experience were distributed among Federal reserve districts according to the location of the accepting institution as follows:

District 1	18 ✓	District 7	27 ✓
2	135 ✓	8	0
3	1	9	0
4	1	10	0
5	0	11	0
6	0	12	6

All districts 188

Reporting Institutions. - Among the 156 institutions which responded to the Committee's questionnaires were practically all of those which the American Acceptance Council reports as accounting for upwards of 90 per cent of the current acceptance business. There were, however, many important acceptors in earlier years, whose names no longer appear on the list. In nearly all instances such institutions were merged with others and the consolidated institution continues to be a leading acceptor and one which responded to the Committee's questionnaire. Your Committee took steps to discover whether existing acceptors accounted for the unfavorable experience suffered by institutions absorbed by them. While every instance of an unsatisfactory credit experienced by a merged institution was not reported to the Committee, investigations would indicate that most of the important ones were. Your Committee feels that the returns in hand are as complete in this respect for all

practical purposes as they need be and that the inclusion of such experiences as may have been omitted would merely emphasize the facts revealed by the responses received.

Bills in Difficulty, 1920-1932. - The questionnaires returned by acceptors indicated an aggregate of \$38,300,000 of bills accepted during 1920-1932 "on which the bank's customer failed promptly to meet the obligation to place the accepting bank in possession of funds to pay the acceptance." Acceptances associated with standstill agreements were not included, as accepting institutions had been told that "it is not desired, however, that these reports be filled out for credits where the only difficulty was a slight delay in receipt of remittance or for credits the maturities of which have been prolonged solely because of standstill or other similar country-wide restrictions."

No acceptance was reported as having been in difficulty prior to 1920.

Indicated Losses, 1920-1932. - In connection with the aggregate of the \$38,300,000 of bills with respect to which the bank customer failed promptly to meet the full obligation, collections through August 1935 had amounted to \$23,300,000; an aggregate of \$4,700,000 was still in suspense; and losses had been written off to the extent of \$10,300,000. These figures, of course, do not include losses incurred by American acceptors in connection with bills included in standstill arrangements with central European countries. This experience will be referred to separately in the latter part of this report and reviewed in detail in the attached supplementary report.

The volume of losses of \$10,300,000 does not appear large when compared with the aggregate acceptance business done during the years 1920-1932, which has been estimated at \$50,000,000,000. The indicated losses, therefore, have been slightly over .02 of 1 per cent of the total acceptance business done during the years 1920-1932; losses plus amounts still in suspense, less than .04 of 1 per cent.

Commission received by the accepting banks for their undertakings, aggregated at least \$125,000,000 on the basis of a charge of 1/4 of 1% for 90 day credits.

Since the primary purpose of this survey was to ascertain from actual experience what change if any should be made in existing law, regulations, or practice in order to correct any evident weakness which may exist in the business of extending acceptance credits, an accurate analysis should be based on the types of transactions which led to difficulty or loss rather than on the dollar amounts involved. Obviously in following the latter course a single transaction involving a very substantial sum might appear to outweigh several other types of transactions aggregating a smaller dollar value. Accordingly the former method would appear to be the better basis for analysis. Unfortunately, however, the replies from reporting banks show only those transactions which resulted in difficulty or loss and there is no way of ascertaining the actual number of transactions of corresponding type which were consummated satisfactorily. As a consequence this survey can indicate only the relationship of the individual types of unsatisfactory credit to the total number of cases involving difficulty or loss.

Large Individual Losses. - Although there were 186 cases of credits in some kind of difficulty from 1920-1932, 92 cases contributed the total losses of \$10,300,000. The number of cases involved is shown by classes of credits in Table 1.

Table 1 - Number of Cases of Acceptance Credits Involving Difficulties and Losses by Class of Credit 1920-1932

Class of Credit	Number of credits in difficulty	
	Total	Involving losses
Import	75	36 - 48 ²⁷
Export	19	12 - 57 ⁴⁵
Domestic shipment	2	1
Domestic storage	28	13
Shipment between foreign countries	49	24 - 50 ⁴⁵
Foreign storage	10	5
Dollar exchange	<u>5</u>	<u>1</u>
Total	188	92

The extent to which the aggregate losses were contributed by a few large cases is striking. For example, losses of \$1,221,000 associated with acceptances executed under import credits during the years 1925-1932 grew out of 25 cases in all, but 4 cases contributed \$827,000 of losses.

In connection with acceptances executed during 1925-1932 involving shipments between foreign countries, \$3,101,000 of losses were recorded, associated with 24 cases, but 4 cases contributed losses of \$1,953,000. These 8 large cases may be briefly described to serve the purpose of illustrating typical situations:

Import Credits

<u>Amount</u>	<u>Date accepted</u>	<u>Transaction</u>	<u>Experiences</u>	<u>Remarks</u>
\$ 225,432.02	1928	Shellac from Far East	Loss \$181,865.33 Balance paid	Customer went bankrupt.
5,000,000.00	1932-1933	Raw silk from Japan	Loss \$250,000 Collected \$4,688,000 Suspense \$ 62,000 (Latter being re- duced by regular payments and be- lieved to be safe.)	Covers period from 1925- 1933. Irregular use of credit by taker in the early days resulted in a loss to the bank, which continued to carry the account in an effort to reduce the deficit, but price decline in 1932 forced a write-off of \$250,000.
830,035.66	Sept.-Nov. 1930	Dried peas from Mexico	\$155,000 written off as a loss. Collected \$673,000 Suspense \$ 2,000	Drop in market value of merchandise, and of securities pledged as collateral.
593,564.54	1928	Copra from Philippine Islands & Dutch East Indies	Loss of \$241,670.58 Balance paid	Takers of credit got into difficulties, making it necessary for bank to take over the manufacture and sales of merchandise. Liens placed by others on some of the merchandise forced liquidation, there- by enhancing bank's loss.

Shipments between Foreign Countries

503,500.00	May 1926	Lumber from Czechoslovakia and Roumania to various countries.	\$302,925.36 Loss Balance paid	Customer failed.
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Shipments between Foreign Countries (cont'd)

<u>Amount</u>	<u>Date accepted</u>	<u>Transaction</u>	<u>Experiences</u>	<u>Remarks</u>
\$ 913,655.17	Aug. 1931	Merchandise from various European countries to other foreign countries.	Loss \$439,000 Balance still in suspense; receiving recoveries.	Customer failed.
1,659,308.82	April 1932	Merchandise from various foreign countries to various other foreign countries.	Loss \$900,000 Balance still in suspense.	Evidence of misrepresentation.
468,211.86	1931	Merchandise from various foreign countries to various other foreign countries.	Collected \$ 52,784.09 Loss 312,195.93 Suspense 103,231.84	Evidence of misrepresentation.

Table 2 shows the distribution of difficulty and losses among seven classes of acceptance credits.

Table 2 - Aggregates of Bills Accepted in 1920-1932 in Difficulty, by Class of Credit - Subsequent Collections, Losses, and Items in Suspense Through August 1935

Type of credit	Total in difficulty	Subsequent collections	Losses written off	In suspense
	(000 Omitted)			
Import	\$16,493	\$11,830	\$ 4,056	\$ 607
Export	3,692	2,103	908	681
Domestic shipment	203	151	50	2
Domestic storage	3,620	2,541	810	269
Shipment between foreign countries	9,457	3,213	3,326	2,918
Foreign storage	3,817	2,517	1,147	153
Dollar exchange	<u>1,058</u>	<u>962</u>	<u>44</u>	<u>52</u>
Total	\$38,340	\$23,317	\$10,341	\$4,682

On the basis of the figures shown in Table 2, it would appear that experience has been least satisfactory among import credits. The aggregate of bills

indifficulty in this class was larger than in the case of any other and losses written off were larger. By these tests transactions involving shipments between foreign countries afforded the next most unsatisfactory experience. In this form the figures are inconclusive, however, since the amount of difficulty encountered in each class of credit needs to be related to the aggregate business done in the category during those years. An effort to do this is the subject of some subsequent paragraphs.

It is possible that actual losses suffered by acceptors may be higher than would appear from those reported, as a substantial part of the \$4,700,000 now being held in suspense has been outstanding for at least three years. Conservative accounting might well have written off some of this aggregate as a loss before now, although reports indicate that a substantial portion of this suspense will probably be recovered eventually.

Losses by Years. - Acceptance difficulties leading to losses were greatest in years of business recession and price decline, such as 1920, 1921, 1924, 1931, and 1932. It will be recalled that this survey did not include any business originating after 1932. Table 3 shows the losses by the years when the relative bills were accepted.

Table 3 - Losses Written Off on Bills Accepted in Each Year 1920-1932
by Class of Acceptance Credit

Year	Import	Export	Domestic shipment	Domestic storage	Shipments between foreign countries	Foreign storage	Dollar exchange	Total
	(000 Omitted)							
Date not furnished	\$ 200	\$ -	\$ -	\$ -	\$ 225	\$ 393	\$ -	\$ 818
1920	1,843	-	-	414	-	-	-	2,257
1921	-	90	-	177	-	475	44	786
1922	-	-	-	-	-	-	-	-
1923	-	-	-	-	-	-	-	-
1924	792	133	-	37	-	-	-	962
1925	5	-	-	-	-	-	-	5
1926	10	10	50	-	303	-	-	373
1927	12	150	-	-	-	261	-	423
1928	465	12	-	5	-	-	-	482
1929	88	-	-	100	30	-	-	218
1930	311	20	-	74	28	-	-	433
1931	80	493	-	3	1,834	18	-	2,428
1932	250	-	-	-	906	-	-	1,156
All years	\$4,056	\$908	\$50	\$810	\$3,326	\$1,147	\$44	\$10,341

Experience, 1925-1932. - In several respects there is a natural division of acceptance experience as between the years ending with 1924 and those beginning with the year 1925. A large increase in the acceptance business as a whole began after 1924, and acceptance practice at some points was improved as a result of lessons learned from unsatisfactory experiences of earlier years. Business in some of the major classes of acceptances, moreover, amounted to little prior to 1925. a.

Chart 1 shows the volume of acceptances outstanding by classes at the end of each month for all available months. Separate figures were not published by the American Acceptance Council for the two classifications "shipment between foreign countries" and "storage in foreign countries."

The chart brings out the fact that import credit transactions had existed in large volume prior to 1925. On the other hand, transactions involving shipments between or storage in foreign countries were negligible in size in 1925 and 1926, began to increase rapidly in 1927, and by the latter part of 1929 exceeded import credit transactions. Acceptances outstanding in the class of foreign storage and shipment at the end of the year 1930 amounted to more than \$550,000,000, while import acceptances outstanding were but slightly more than \$200,000,000. k.

The rapid increase following 1927 in acceptances outstanding to finance shipments between or storage in foreign countries reflects in part revision by the Federal Reserve Board of its rulings to permit the acceptance of bills in export transactions after the goods had actually arrived at their destination. This broadening of ruling followed some recession in trade in 1924 and in 1927, and was particularly designed to assist in furthering our exports of cotton and other raw products.

Table 4 shows by class of credits the experience with respect to difficulties on bills accepted in the years 1925-1932.

BANKERS ACCEPTANCES OUTSTANDING BY TYPE OF TRANSACTION

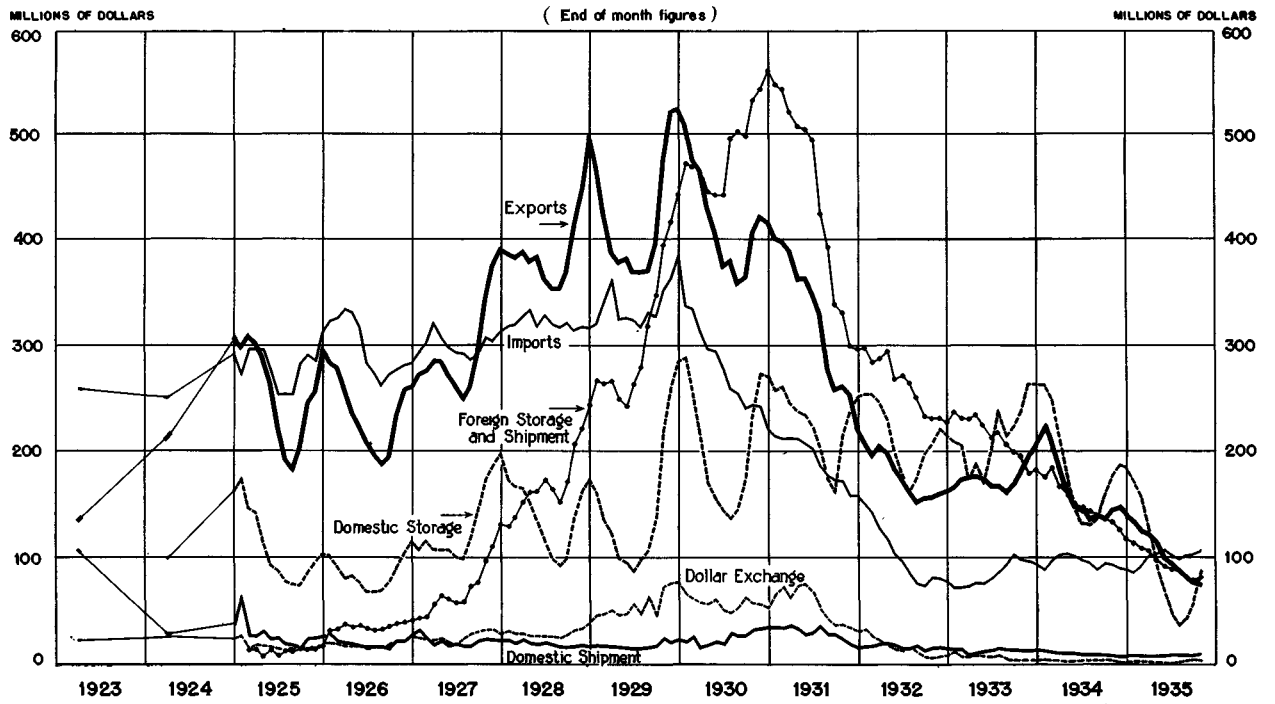


Table 4 - Aggregate of Bills Accepted in 1925-1932 in Difficulty by Class of Credits - Subsequent Collections, Losses and Items in Suspense Through August 1935

Class of credit	Total in difficulty	Subsequent collections	Losses written off	In suspense
	(000 Omitted)			
Import	\$ 8,889	\$ 7,111	\$1,221	\$ 557
Export	2,694	1,305	708	681
Domestic shipment	203	151	50	2
Domestic storage	1,840	1,412	182	246
Shipment between foreign countries	8,872	2,853	3,101	2,918
Foreign storage	2,933	2,501	279	153
Dollar exchange	674	622	-	52
Total	\$26,105	\$15,955	\$5,541	\$4,609

The table brings out the fact that when acceptance experience after 1924 is viewed separately the unsatisfactory experience in the import credit classification based solely on dollar amounts involved no longer overshadows that in some other classes. Total acceptances in difficulty in the import credit class amounted to \$8,889,000 on which losses of \$1,221,000 were written off while \$557,000 of bills were still in suspense. Among credits involving shipments between foreign countries, total acceptances in difficulty amounted to \$8,872,000 on which losses of \$3,101,000 were written off while \$2,918,000 of bills were in suspense.

Difficulties Compared with Volume Outstanding. - The bare aggregates of difficulties give no indication of their relative significance in the various classes, but should be related to the volume of acceptances which have been negotiated in the various classes during the period.

The volume of acceptances in the various classes executed in each year during 1925-1932 has been estimated by multiplying the average outstandings by 4 since the acceptance business turns over roughly every 90 days. The following tabulation shows the estimated volume of acceptances negotiated.

Table 5 - Estimated Volume of Acceptances Negotiated during 1925-1932
by Class of Credits

Class of Credit	1925	1926	1927	1928	1929	1930	1931	1932	Total
(Millions of dollars)									
Import	\$1,123	\$1,186	\$1,204	\$1,283	\$1,355	\$1,105	\$ 762	\$ 405	\$ 8,423
Export	1,025	941	1,189	1,572	1,688	1,668	1,286	705	10,074
Domestic shipment	99	78	84	72	71	100	115	66	685
Domestic storage	425	344	524	559	604	825	902	848	5,031
Shipment between and storage in foreign countries	47	140	291	692	1,249	1,956	1,732	1,048	7,155
Dollar exchange	67	74	101	115	224	229	217	62	1,089
Total	\$2,786	\$2,763	\$3,393	\$4,293	\$5,191	\$5,883	\$5,014	\$3,134	\$32,457

When the aggregate losses suffered by classes of bills drawn during the period 1925-1932 are compared with the volume of acceptances negotiated, it would appear that relative losses were more significant among credits involving shipment between and storage in foreign countries than in the other classes. Losses plus items still in suspense were four times as much as those among import credits. As previously noted these figures do not include credits covered by standstill agreements which will be referred to later. Too much weight should not be given to this comparison based on dollar amounts, as the credits based on shipments between and storage in foreign countries on which losses were taken happen to include a number of large transactions. (See Table 1)

Table 6 shows the difficulties per \$100 of bills negotiated during 1925-1932.

Table 6 - Aggregate of Bills Accepted in 1925-1932 in Difficulty per \$100 of Estimated Total of Bills Accepted in 1925-1932 by Classes of Credits

<u>Class of Credit</u>	<u>Total in difficulty</u>	<u>Losses written off</u>	<u>In suspense</u>	<u>Losses plus suspense</u>
Import	\$0.106	\$0.014	\$0.007	\$0.021
Export	.027	.007	.007	.014
Domestic shipment	.029	.007	-	.007
Domestic storage	.037	.003	.005	.008
Shipment between foreign countries and storage in foreign countries	.165	.047	.043	.09
Dollar exchange	<u>.062</u>	<u>-</u>	<u>.005</u>	<u>.005</u>
All classes	.426	.078	.067	.145

It would appear from the analysis made by your Committee that in some of the acceptance business acceptors have not shown a high degree of vigilance in assuring themselves that their business was carrying a minimum amount of risk. For example, there were losses of \$3,326,000 suffered in credits involving shipments between foreign countries. With respect to practically all of the bills the acceptor was unable to furnish information as to what disposition was made of the goods against which the credit was drawn. With respect to a quarter of the aggregate, the acceptors had never seen documentary evidence that any goods had been shipped but had relied upon the statements of correspondents or others.

Long Maturities, Renewals, Revolving Credits. - In all, there were 92 credits on which losses were incurred. In 16 cases, these involved bills with maturities in excess of 90 days, while there were 20 cases of renewal bills and 22 cases of revolving credits. There were cases where two or three of these conditions were characteristic of one particular credit, but in all there were 49 separate credits which were characterized by one or more of these conditions.

Out of \$10,341,000 of losses, \$6,260,000 were on credits which involved one or more of these characteristics, although it is impossible to determine how much of this loss was due to these factors and how much coincidental.

Goods Released on Trust Receipts. - Half of the \$4,056,000 of losses incurred on import credits were in connection with transactions in which the goods were released on trust receipt. Losses in the other classes of credits were not associated with trust receipt transactions.

Losses by Underlying Commodities. - Sugar credits were responsible for \$2,500,000 of the aggregate losses of \$10,300,000. Credits on peanuts and peanut oil contributed losses of \$644,000 and coffee credits, \$568,000. The losses on sugar occurred largely in connection with import credits, though a sizable loss occurred in foreign storage transactions. There were important losses in transactions involving shipment between or storage in foreign countries in credits on sugar, coffee, lumber, and tobacco, in importance in the order mentioned.

Losses by underlying commodities and class of transaction are shown in some detail in Table 7.

Table 7 - Losses on Bills Accepted in 1920-1932 by Underlying Commodity and Class of Credit

Commodity	Import	Export	Domestic shipment	Domestic storage	Shipment between foreign countries	Foreign storage	Dollar exchange	Total
Sugar	\$1,635	\$ -	\$ -	\$ 23	\$ -	\$ 885	\$ -	\$ 2,543
Peanuts & peanut oil	644	-	-	-	-	-	-	644
Coffee	30	-	-	3	535	-	-	568
Furs	149	-	-	278	-	-	-	427
Lumber & timber	-	-	50	-	333	-	-	383
Tobacco	42	-	-	-	-	262	-	304
General merchandise	-	201	-	-	92	-	-	293
Railway equipment	-	-	-	-	281	-	-	281
Skins & hides	260	-	-	-	-	-	-	260
Silk	257	-	-	-	-	-	-	257
Wool	48	-	-	214	-	-	-	262
Copra	242	-	-	-	-	-	-	242
Metals	-	224	-	-	5	-	-	229
Hardware & industrial machinery	-	200	-	-	-	-	-	200
Shellac	182	-	-	-	-	-	-	182
Wood oil	200	-	-	-	-	-	-	200
Woolen yarn	-	-	-	-	172	-	-	172
Dried peas & beans	162	-	-	-	-	-	-	162
Wheat & grain	-	-	-	105	-	-	-	105
Shoes	-	90	-	-	-	-	-	90
Packing house products	-	88	-	-	-	-	-	88
Groceries	-	-	-	77	-	-	-	77
Paper	73	-	-	-	-	-	-	73
Autos & motors	-	49	-	-	20	-	-	69
Cotton	-	22	-	27	-	-	-	49
Burlap	48	-	-	-	-	-	-	48
Spices	-	-	-	46	-	-	-	46
Rubber	-	-	-	37	-	-	-	37
Oil	-	34	-	-	-	-	-	34
Miscellaneous	84	-	-	-	1,888	-	-	1,972
Dollar exchange	-	-	-	-	-	-	44	44
Total	\$4,056	\$908	\$50	\$810	\$3,326	\$1,147	\$44	\$10,341

Losses and Banking Judgment. - Of the aggregate losses revealed by the analysis made by your Committee a large proportion was incurred by a few institutions, five accounting for 64% and ten for 83% of all losses. It is true that these institutions were among the largest acceptors, but many other large acceptors reported much smaller losses. It is a fact worthy of note that the reason assigned as to why the acceptor was forced to absorb a loss was in so many cases a reflection of faulty banking judgment, or of a possible lack of proper vigilance. Table 8 brings out the fact that a large proportion of the recorded losses was associated with failure of the borrower, or price declines, or condition in the trade, or fraud. These are matters that it would be difficult to guard against by provisions in the Board's regulations dealing with acceptances.

Table 8 - Reasons Assigned for Amounts of Losses Incurred on Bills Accepted during 1920-1932 by Class of Credit

Cause of Loss	Import	Export	Domestic shipment	Domestic storage	Shipment between foreign countries	Foreign storage	Dollar exchange	Total
Customer failed	\$1,570	\$262	\$ 7	\$104	\$1,070	\$ 18	\$ -	\$3,024
Price decline	1,729	-	-	459	-	-	44	2,232
Condition of trade	41	-	-	59	75	-	-	175
Fraud and misrepresentation	52	459	-	142	1,387	654	-	2,694
All other	<u>664</u>	<u>187</u>	<u>50</u>	<u>46</u>	<u>794</u>	<u>475</u>	<u>-</u>	<u>2,210</u>
Total	\$4,056	\$908	\$50	\$810	\$3,326	\$1,147	\$44	\$10,341

American Acceptance Credits Under Standstill Agreements. - So far, this report has been confined to a survey of the experience of American banks in connection with acceptance credits executed between the years 1920 and 1932 inclusive and supplies a reasonably complete analysis of such unsatisfactory cases as have occurred in the acceptance business as it has grown up under existing statutes and regulations.

It has omitted any study of the so-called standstill agreements: arrangements which applied to short term credits, and which were established between foreign creditor banks and their customers in certain countries whose governments, because of economic conditions, adopted restrictive regulations controlling the conduct and settlement of foreign trade accounts.

The purpose of such agreements, generally speaking, has been two-fold: to prevent wholesale withdrawal of foreign capital which would be ruinous to the exchange value of the currency and to overseas trade, and to enable creditors over a period to liquidate their commitments in as orderly a manner and at as little sacrifice as possible.

Inasmuch as the problem created by these agreements is in many respects quite outside the field of ordinary acceptance experience, it seemed to your committee to warrant a separate and rather detailed analysis by itself. Accordingly such an analysis has been made as a supplement to this report. It seems appropriate to include in this report, however, a summary as to two points, the losses sustained by accepting banks, and the character of the paper drawn under credits made subject to standstill agreements.

Losses Incurred in Standstill Liquidation. - It should be borne in mind that the agreements arose not from the inability of the debtors to meet their obligations in their own currencies but from their inability to make transfers of funds through the normal channel of the exchanges. This is confirmed by most of our accepting banks, as illustrated by the comment of one of the institutions whose experience is included in this survey. The bank in question, after referring to the prolongation of credits by the various standstill arrangements with central European countries and exchange controls which have stopped payment for goods in gold, goes on to state that they have many customers who, although possessed of ample resources, are prevented by government decrees from converting these resources to make possible payment of contracted obligations. Furthermore, the great majority of credits extended by American banks under the most important standstill agreement, that with Germany, have been guaranteed by German banks, and public policy has not permitted

any of the latter to suspend payments. Hence losses which creditors have incurred in connection with acceptance credits subject to standstill agreements have not arisen from fault in the individual credit but have been due almost wholly to the discount incident to the conversion of foreign currencies into dollar exchange under existing governmental controls.

Since this discount has ranged from about 15% to 51%, the loss to accepting banks has been substantial. In the case of Germany, for example, American banks in liquidating some \$246,000,000 of acceptance credits up to December 1935 may have lost something between \$32,000,000 and \$45,000,000 in disposing of registered mark balances. Furthermore there have been losses in liquidating Austrian and Hungarian commitments although absence of available data does not permit of an estimate of the amount of these losses. Complete figures of loss in connection with standstill credits would loom large beside the \$10,000,000 loss shown in other parts of this report on all other American acceptance business of some \$50,000,000,000. Under the circumstances outlined above, however, losses under the standstill are of a quite different type from those incident to the ordinary practice of the acceptance business.

Character of Acceptances Subject to Standstill Agreements. - The second important consideration in reviewing standstill experience is the character of the paper drawn under existing credits. There can be no doubt that a substantial volume of such drawings partook at one time or another of the nature of finance paper and was not supported by actual commercial or industrial transactions which would provide self-liquidation for the bills which our banks were called upon to accept.

The Committee has examined the available figures and has asked the opinion of competent bankers with respect to the extent of any laxness in practice and the circumstances under which it occurred. The only figures which are available on the subject relate to the period after the standstill agreements had gone into effect. Reports of 100 American banks, as of October 31, 1935, indicate that of \$288,000,000 of acceptances outstanding on that date under the German Standstill Agreement, 39%

were accompanied by proof of eligibility such as shipping documents or other evidence; 31%, although unaccompanied by documentary evidence, were nevertheless presumably capable of classification as eligible; and 30% were definitely not self-liquidating and offered no evidence as to the nature of the underlying transaction. Informal inquiries among twenty-five of the most important accepting banks indicate that at the end of 1935 about three-quarters of the bills outstanding at that time could be classified as eligible under the regulations of the Board of Governors of the Federal Reserve System.

In interpreting the foregoing data it should be noted that they reflect operations four years after the standstill agreements went into effect.

German authorities, as well as many accepting banks, maintain that until recession in foreign trade set in and commodity prices began to fall, the great majority of bills presented for acceptance represented actual self-liquidating business transactions. There is, however, considerable testimony that even before the standstill agreement had gone into effect some American acceptors had been at times lax in depending on general statements made to them by foreign banks and not requiring more detailed information regarding the transactions underlying the bills accepted. Such practice has been at times defended on the ground that it is similar to the practice of London bankers who have generally placed more reliance upon names than on ascertaining that the underlying transaction back of each bill was by nature self-liquidating. There is no way of knowing the extent of the laxity which existed in this particular, although belief in the market is that it was not general. It does not appear that laxness of this sort had any important responsibility for the later losses on acceptances except to the extent possibly that a more exact scrutiny of bills might have led to a somewhat smaller volume of credit extension and so to a smaller volume of bills coming under the standstill agreement. The probability is, however, that more precise technical requirements would not greatly have restricted the volume of bills drawn. The total volume of bills was in keeping with the general

tendency of the time toward excessive credits of all sorts to the central European countries.

It is clear that an important change in the character of bills took place at the time the standstill agreements went into effect. With the decrease in volume of transactions which could give rise to eligible bills, many foreign customers of accepting banks found it increasingly difficult to provide eligible paper, although they were still in need of working capital. Under the standstill agreement, the Germans agreed to provide eligible paper as far as possible and the right is reserved, when it is not possible, to carry the resulting debt in the form of a cash advance or overdraft, of course at a higher rate of interest. The majority of accepting banks have so treated bills which were not definitely self-liquidating. Indeed, to a large extent they have kept their German bills off the market entirely.

Although the large amount of finance paper which admittedly existed can scarcely be reconciled with the ideals of the best banking practice, losses incurred by American acceptors due to this cause have been negligible, since, as stated above, the majority of American credits were guaranteed by German banks which as a matter of public policy have not been allowed to fail.

By far the greater part of American acceptance credits subject to standstill agreements have been extended to German banks which in turn made them available to their commercial and industrial customers. Consequently, there have been numerous substitutions of one debtor for another as well as changes in the types of transactions underlying the bills presented for acceptance. In addition, not infrequently original acceptances have become overdrafts and subsequently been replaced by bills which again have become overdrafts so that except in relatively few cases there has been no real continuity of individual credits. For these reasons it does not appear possible to apply the same methods of analysis to individual acceptances as were used in the earlier part of this report. The supplementary report appended herewith deals in greater detail with standstill experience.

Acceptors' Recommendations for Changes in Rules of Procedure. - Of the 156 banks which responded to the questionnaires only about 20 made definite recommendations as to changes in the law or regulations relative to acceptances. The recommendations may be classified: (a) for more restrictive requirements; (b) for liberalizations.

More Restrictive Requirements. - In connection with more restrictive requirements, the largest number of suggestions were made with respect to shipments between foreign countries and the smallest number with respect to import credits. A brief summary of these suggestions is given by class of credit as follows:

Import Credits:

When goods released on trust receipt, latter should not remain outstanding after transaction completed.

Export Credits:

Restrict financing with respect to secondary distribution to such merchandise as remains in original form.

Documentary evidence desirable when acceptance drawn by another bank and secured by export bills.

Actual documents should be in hands of acceptor from date of acceptance.

Domestic Shipment Credits:

When goods released on trust receipt, latter should not remain outstanding after transaction completed.

On six months' drafts, tenor should be restricted to that of eligibility for rediscount.

Credits Covering Shipments between Foreign Countries:

Acceptor should see satisfactory evidence of shipment.

Foreign correspondent should furnish full information with respect to purpose, customer, and self-liquidation.

Basis of transaction should be more clearly defined.

Same requirements as for domestic shipment should apply.

Only banks specifically authorized by Federal Reserve Board should do this business.

Require letter of guarantee from actual taker of credit.

Domestic Storage Credits:

Require adequate insurance coverage.

Emphasize independence of warehouse from credit taker.

On six months' bills tenor should be restricted to those eligible for rediscount.

Require accepting bank to secure sworn statement from warehouse. Restrict business to licensed warehouses only.

Require licensed grader's certificate.

"Specifically, we wish to call attention to the fact that Article B of Regulation A recites that the Federal Reserve Bank may discount bills covering the storage of readily marketable staples, provided the bill is secured at the time of acceptance and that under certain conditions a Trust Receipt may be taken. Article A of Regulation C recites that member banks may accept such bills, but it is not indicated that a Trust Receipt may be taken. It would, therefore, appear that a member bank could accept a bill having warehouse receipts in its possession at the time of acceptance and might release the security free, provided it remained within the 10% of capital and surplus limit. Such a bill, however, would appear to be ineligible for discount under Regulation A."

Foreign Storage Credits:

Acceptor should see satisfactory evidence of storage.

Modify regulations restrictively.

Require letter of guarantee from actual taker of credit.

Dollar Exchange Credits:

Submit each credit to Federal Reserve Board for approval.

Restrict to amounts which may be covered in due course by export documentary bills.

Review list of countries.

Soundness of this type of credit questionable.

General:

Limit acceptance business to transactions where evidence of shipment presented.

Ten per cent limitation of credit extension to one individual should be applicable to acceptances. Excess should be actually secured.

Maturity of acceptance should coincide with usual credit period. Add to Article B, Section XI: "Where the details of the underlying commercial transaction are not otherwise evidenced, the acceptor shall obtain a statement of its essential details."

Actual bills of lading should pass through bank.

It will be noted from the foregoing that the greatest unanimity as to suggestions relative to any one phase of acceptance practice is evident in the category of credits covering shipments between and storage of goods in foreign countries.

Many of the suggestions appear to be so obviously matters of ordinary credit judgment and plain common sense that it would seem scarcely necessary to embody them in formal rules and regulations.

Suggestions for Liberalizations. - Proposals for liberalizing the law and regulations were made with respect to two classes of credits: domestic shipment and domestic storage. Removal of the 50 per cent limitation with respect to domestic acceptances was suggested by several acceptors. Broadening the list of commodities eligible for domestic storage credits was also mentioned. With respect to credits growing out of domestic shipment, it was recommended that the requirement as to documents conveying security title be liberalized.

A significant point of view was expressed by several acceptors, one of which stated:

"We realize that at the inception of the acceptance business in this country a certain degree of regulation was required in order that this new form of credit should not be directed into improper channels, but it is now pertinent to inquire whether the increased understanding of the nature and objective of this facility does not merit a complete revision of these requirements.

"This is particularly true of transactions for domestic account. We feel that too often the mere fact that a transaction measures up to the standards established by the Federal Reserve Bank in defining eligibility has swayed the judgment of the accepting bank as to its soundness as a banking proposition. Obviously, eligibility is no criterion for judging credits, but it is apparently an undeniable influence due possibly to the emphasis that the Federal Reserve Bank rulings place on the matter of eligibility. We feel the time must come when the Federal Reserve

Bank should place its chief reliance on the judgment and standing of the accepting bank, and use that more as a standard for purchasing or discounting bankers acceptances, rather than the fact that the bill offered complies to the letter of certain regulations. Other accepting markets have effectively controlled their acceptance business in this manner without the restrictions of well meant, but inelastic regulations."

General Suggestions. - In addition there were some noteworthy suggestions of a general nature concerning procedure outside the field of regulations.

"We might suggest that the Act and Rulings now governing the American acceptance business be so condensed as to be readily available for reference purposes."

". . . the Federal Reserve Bank, because of its relation to the acceptance market, through the buying rate and its own purchases of bills, is in an exceptionally good position to centralize the available information regarding the extent and distribution of the acceptance business, and to assist the accepting banks and accepting houses to handle the business along sound lines; that the practice of making this information available confidentially is, we believe, a constructive step and should help to avoid a recurrence of the condition of excess advances to certain foreign countries which developed prior to 1930."

". . . For example, if it could be agreed that no acceptance facilities would be put at the disposal of any customer unless the banks receive semi-annual audited statements, an important step in the right direction would have been accomplished. Under the present system we are sometimes told by a client that such and such a bank is not insisting on audited statements, and that if we wish to do business with them we must be satisfied with their own figures.

"Closer cooperation among the banks would also enable a more careful following of trust receipt funds, and bring about a more careful adherence to the specific terms of a trust receipt.

"Past experience has shown the difficulty of getting the New York accepting banks and bankers to act together on points of this kind. However, some progress along this line might be made if the Reserve Bank would call a meeting of representatives of certain of the larger acceptors or bring the matter to the attention of one of the existing inter-bank committees."

"Accepting banks should of course observe the regulations strictly. The Federal Reserve Bank might find it desirable to resume the practice of making test checks by asking the accepting banks to furnish full particulars of the underlying transactions, on acceptances which it may select from time to time."

Conclusions

The statistical analysis pursued by your Committee confirms the impression heretofore prevailing in most quarters that the preponderant part of the acceptance business of American banks as it has grown up under the guidance of the regulations of the Board has been satisfactory. There is no recorded instance of an investor in bankers acceptances having lost a dollar of principal and no bank has closed or suspended payments because of difficulties arising from its acceptance business. The analysis has shown that losses which have been suffered by American institutions because of their acceptance commitments have been for the most part associated with the types of eventualities which should be forestalled more by the judgment, prudence, and vigilance of bankers than by official regulations. Of the \$10,300,000 of losses suffered by acceptors in the years 1920-1932, not including the losses growing out of standstill business, about 80 per cent were associated with such matters as: failure of the customer, price declines, conditions of the trade, and fraud.

It seems to your Committee, however, that this record does not justify an attitude of complacency on the part of the Federal Reserve System in its general responsibility for the rules and regulations under which American acceptance business is done. We hold the view that the bankers' acceptance should be the prime commercial credit instrument, and that acceptances which come into the market should be based on transactions as nearly riskless and above suspicion as possible. On such a premise, any loss in the field should be the occasion of regret and of effort to foreclose its recurrence.

The statistics indicate that, even omitting standstill credits which are a separate problem, the greatest amounts of unsatisfactory experience were encountered in the fields of shipment between and storage in foreign countries, and import transactions.

There is, however, considerable ground for believing that American banks did not uniformly adhere to the ideals of acceptance practice in their central

European business. In the light both of this study and the experience with standstill bills, many acceptors have expressed the belief that the regulations should be tightened to raise the standard of acceptance practices in the field of shipment between and storage in foreign countries. With respect to such transactions several recommendations made by acceptors looked in the direction of requiring that the accepting bank be in possession of full information as to the financial responsibility of the recipient of the credit and the self-liquidating nature of the transaction, and that a more adequate control over the goods by the agent of the accepting institution should prevail until the credit be liquidated. This point of view was particularly well expressed by one important accepting bank:

"When the use of the acceptance facility was initially fostered and laws and regulations formulated, every effort was made to prevent the acceptance of purely finance bills, and provisions were made for exhibition of documents evidencing related actual self-liquidating transactions as the basis for acceptance financing. Later the regulations were modified and the broadest latitude permitted member banks in determining eligibility. This greater freedom resulted in certain abuses, improper practices and the creation of bills not even remotely associated with transactions which would liquidate within the life of the bill. Instances of this nature have been submitted to the standstill committees with which you are familiar. While the broad powers granted acceptors are highly advantageous and desirable, we suggest the possibility that the creation of such bills should be determined by more definite regulations as to the type and extent of evidence which should be required by prospective acceptors as to actual contracts of sales to be financed or actual movements of goods before bills are accepted as eligible."

The evidence the Committee has assembled indicates there is room for some improvement of practice along the lines of the foregoing quotation, especially with respect to bills covering shipment between and storage in foreign countries. The Committee has raised three questions with respect to this problem:

- (1) Whether the general field of acceptance activities should be narrowed,
- (2) Whether some additional and more specific regulations should be issued on this point,
- (3) Whether reliance should be placed mainly upon the gradual

development of sound traditions of practice on the part of accepting banks.

These three questions will be discussed in order.

(1) In the early stages of this project, the question was raised in the Committee as to whether "American banks are justified in granting acceptances to accommodate world trade other than incidental to facilitating the needs of American customers directly engaged in exporting or importing goods between the United States and a foreign country." This challenge involves, of course, the question of the "necessity for permitting banks to grant acceptance credits to finance (a) movement of goods between two foreign countries each foreign to the United States; (b) storage of readily marketable staples in foreign countries whether or not underlying commodities were produced in the United States."

The fact that acceptance activities have been authorized and practiced extensively in a field in the past creates a strong presumption against prohibiting them in the future. If American accepting institutions can find a profitable and reasonably safe field of activity in financing foreign shipment and storage transactions, no sufficient reason for foreclosing the opportunity seems apparent to your Committee. From the point of view of the balance of payments of the United States the outstanding commitments of American investors in acceptances drawn to finance transactions involving shipment between and storage in foreign countries have the same effect as an equal volume of any other type of short term lending. Out of the contacts and good-will incident to acceptance activities in this field grow other satisfactory business for American banks and their customers.

More than this, if reference is made to British acceptance practice, it is found that the extension of American activity into the field of purely foreign transactions has good precedent. The best information indicates that a large proportion of the acceptance liabilities of important British banks relates to transactions in which neither the buyer nor the seller of the merchandise is a resident of the British Isles, or of a British dominion for that matter. It is to be presumed

that in the future the money market in this country will be called upon to fulfill many of the functions of a world money market and the regulations governing acceptance practice should, as far as it may safely be done, provide sufficient latitude for the proper fulfillment of that function.

(2) As previously noted several of those replying to the Committee's questionnaire have suggested the modification of Federal Reserve Board regulations to include definite specification of the type and extent of evidence which should be required by prospective acceptors as to the actual contract of sales to be financed or actual movements of goods before bills are accepted as eligible. The present regulations as they relate to the financing of transactions arising out of the importation or exportation of goods are drawn in broad terms and make no specific requirements as to the character of evidence accepting banks must obtain. The conditions under which transactions of this sort take place are so varied that it would be difficult if not impossible to draw a regulation which would lay down minutely requirements as to evidence without making compliance impossible in many sorts of transactions. For example, in many cases of shipments of goods between foreign countries it would be impossible for the accepting bank to obtain shipping documents at the time of the acceptance. It does, however, seem possible that the regulations should contain a general requirement that with respect to credits covering export and import transactions and shipments between foreign countries, the accepting bank is expected to obtain satisfactory evidence, documentary or otherwise, as to the precise nature of the transactions underlying the credit extended. Such a general requirement in the regulation serves notice on accepting banks as to what may be regarded as sound acceptance practice, and provides a basis for the examination of individual credits which may be made later by bank examiners or the Federal reserve banks.

(3) While as noted above the Committee received a number of suggestions for changes in regulations the Committee was constantly impressed with the number of comments to the effect that sound acceptance practice depended upon credit judgment

and the development of sound traditions. This point of view was well expressed by the officer of one of the large accepting banks in the following language:

"I cannot help but take this opportunity of reiterating *** that primarily acceptances are an instrument of credit and their value is based on the soundness of our judgment of the credit risk involved. It is my impression that the eligibility provisions have a tendency opposite to their original intention. To the inexperienced I believe they endow transactions which can be classified under the regulations as eligible with a primary assumption of soundness. A credit risk, of course, does not depend upon the nature of any single transaction but many other factors enter into the credit risk independent of the transaction itself."

Recommendations

- ✓ (1) It is recommended that the acceptance privilege be not withdrawn from any of the seven important fields.
- ✓ (2) It is recommended that further liberalizations in regulations of the Board of Governors be not made at this time.
- ✓ (3) It is recommended that a footnote be added to subparagraph (1) of Section XI of Regulation A reading as follows:

While it is not a requirement of the eligibility of bills referred to in clause (1) of Section XI of this regulation that documents covering the shipment of goods be attached to the bills at the time of acceptance, it will be presumed by Federal reserve banks in discounting such bills that the accepting banks have obtained satisfactory evidence as to the transactions underlying such bills.

- (4) It is recommended that continued emphasis be placed on the procedure of check-up through examinations. In keeping with this proposal the Reserve Board on January 29, 1935, addressed letters to the Federal Reserve Agents and the Comptroller of the Currency requesting that when examinations of members of the Federal Reserve System were being made attention be paid to whether the acceptance

business of the respective bank was being conducted in conformance with the law and regulations of the Board.

(5) It is also recommended that the Federal reserve banks, in addition to their usual scrutiny of bills from the standpoint of eligibility and acceptability, make at frequent intervals a more extended investigation of bills which are purchased or offered for purchase in order to ascertain whether the acceptances are conforming with sound acceptance practice.

It must be recognized that in the long run sound acceptance practice depends most largely on sound credit judgment on the part of the accepting bank, and the principal reliance for improvement in practice must be placed upon the gradual process of the seasoning of judgment of acceptors and the development of sound traditions.

W. Randolph Burgess
Ira Clerk