BANKING PRINCIPLES AND PRACTICE

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VOLUME V

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CHAPTER LIII

ADMINISTRATION OF THE FOREIGN DIVISION

Characteristics of Foreign Commerce

Foreign commerce embraces the mercantile and financial transactions between the citizens of different countries as well as some direct transactions between their governments. Though foreign commerce closely resembles domestic commerce in most respects, there are important differences. With the exception of trade with Canada and Mexico, the foreign commerce of the United States is by sea and over long distances; hence it is almost completely dependent upon the mercantile marine, and the channels of trade are through a limited number of ports.

Domestic commerce is conducted under one commercial language, and one system of currency, customs, and laws, whereas foreign commerce is between countries which differ in these respects. Commerce within a state is subject to state law; commerce between the states is subject to federal law; but in international commerce there is no super-government, no international courts of commerce, no international laws establishing legal tender, no laws fixing uniform rates for carriers, and no laws compelling carriers to insure their ladings. Payments must, therefore, be made in a tender acceptable to the debtor; shippers must bargain with carriers for rates and service and must insure their shipments; disputes must be settled by arbitration or by chancery under the laws of the state of the debtor or creditor, and so on.

Foreign commerce is vitally affected by the foreign policies of the trading countries. For reasons of military protection, national pride, and political and economic considerations, the trading nations encourage, by means of bounties, lower freight rates and the like, the exportation of certain commodities, and discourage by means of tariffs, embargoes, quarantine, and similar measures, the importation of other products. A nation may allow the formation by its citizens of combinations for the purpose of engaging in foreign business and prohibit similar combinations in domestic business.

The collection of import duties requires the examination by custom officials of all imports. The foreign trader uses invoices, manifests, clearances, custom-house bonds, insurance and inspection certificates, and other necessary papers, whereas domestic trade is carried on with comparatively few commercial papers. The financing of international commerce tends to concentrate in a few cities, particularly London and New York.

The conduct of foreign commerce is facilitated by numerous agencies both public and private. The government provides a consular system, a Bureau of Foreign and Domestic Commerce, a Weather Bureau, a Bureau of Navigation, a foreign mail service, improved channels, ports, lighthouses, etc. Private citizens provide a merchant marine, banking and marine insurance facilities, cables and wireless telegraphy, and other aids.

The personnel and mechanism of the foreign trade embrace exporters and importers, freight-forwarders, commission houses, resident and traveling buyers and sellers, branch houses, merchandise brokers, advertising agencies, marine underwriters, insurance brokers, shipping companies, ship-brokers, custom house brokers, bankers, note-brokers, and others. It is apparent, therefore, that the conduct of foreign commerce is divided among highly specialized groups. The evolution of foreign trade has been characterized by this specialization of functions. The early English merchants performed all these functions to the degree that they were then performed; they were at one and the same time shipowners, importers, merchandisers, underwriters, bankers, etc. In the process of their evolution their financial operations tended to absorb their attention, and the term "merchant banker" or simply "merchant" came to signify "banker." It is so used today.

Institutions Engaged in Foreign Banking Operations

The phase of foreign commerce treated in this book is its finance. Some of the financing is done by the import and export mercantile houses. Occasionally such a house is closely affiliated with a bank and conducts mercantile operations which are largely financed by that bank, as, for instance, the Mercantile Oversea Corporation, affiliated with the Mercantile Bank of the Americas. The express companies handle the remission of money and issue travelers' checks. The post office conducts an international postal money order business. Foreign banking in the United States is very largely performed by private and commercial banks and by agencies of foreign banks. In London many acceptance houses specialize in the issuance of letters of credit and the acceptance of bills drawn under them. Similar houses have been slow to arise in New York, as have also the discount houses which specialize in the purchase, distribution, and sale of discount paper. A few of our large commercial banks, both state and national, have developed branches and agencies abroad, but most American banks rely upon a system of correspondents. The recent development of the discount market, of the federal reserve banks, and of American marine insurance companies has done much to promote foreign banking.

The policy of the several states has been to restrict the operations of the branches and agencies of foreign banks in New York and other American cities. The two powers generally denied such institutions are to receive deposits and to make loans freely. Legal restrictions narrowly limit the business of these foreign agencies to foreign exchange and a few minor banking functions. The New York banking law provides that the superintendent of banks may license such a foreign bank with power to do the "business of buying, selling, or collecting bills of exchange, or of issuing letters of credit, or of receiving money for transmission or transmitting the same by draft, check, cable, or otherwise, or of making sterling or other loans, or transacting any part of such business." These agencies are among those which are not permitted to employ any part of their "property or be in any way interested in any fund which shall be employed for the purpose of receiving deposits, making discounts, or issuing notes or other evidences of debt to be loaned or put into circulation as money." Foreign trust companies are similarly prohibited from doing a trust business in the United States.

This prohibitive attitude of New York State has recently made it difficult for American banks to establish branches abroad, for the reason that foreign countries naturally look for reciprocity in the granting of powers to such branches and agencies. The restrictions are rightfully regarded as provincial and retard the growth of New York as the financial center of the world. It seems fit and proper that our laws be relaxed in this matter, so long as the safeguards of sound banking are not impaired and no advantage is given to foreign agencies over our own banks. Such an extension of powers would probably not seriously affect the interests of our banks, and foreign agencies could serve better the special trade or financial interests which they represent.

The Nature and Development of the Foreign Division

In practically every bank of the United States what is here named "foreign division" is called "foreign department." This nomenclature is confusing because the foreign department of a large metropolitan bank is composed of departments which are in all essentials co-ordinate with the departments of the domestic division. What in its beginning was properly a department of the bank created to handle its foreign business has so grown in many banks as to constitute a parallel and co-ordinate division, composed of departments similar and co-ordinate with those of the domestic division.

The "foreign division," as here used, therefore, embraces the numerous departments of a bank that handle all financial items and transactions to which a foreign state or a firm, association, corporation, or citizen of a foreign state, is party. These operations are many in number and diverse in kind. A considerable number performed in the domestic or general division of the bank are similar to those carried on in the foreign division; and the foreign division performs many additional operations occasioned by the peculiarities of international business. The result is that the foreign division is practically a bank in itself, more or less distinct from the domestic or general division.

The relation of the two divisions in many banks is undergoing a change. When a foreign division was first organized, the common practice was to import a foreign exchange expert manager from England or Germany to organize and operate it. American bankers were without experience or training in this field and had to recruit the division abroad. The directors of the bank then voted to loan to the foreign division a certain amount of money at the same rate as on other loans. The foreign division was regarded as a borrowing customer of the domestic division, paying to the domestic division interest and rent, and reimbursing it for the light, stationery, and other materials used, the expenses other than interest—including the overhead and running expenses of the division—being allocated on some suitable basis between the two divisions.

The managers of the foreign division were then responsible for its financial success, and the degree of its success could be definitely determined by its net profits. This debtor-creditor relation between the divisions led the credit men of the bank to rate the credit title of the foreign division much as they would that of a private borrower; its assets were regarded as excellent, being self-liquidating and convertible into cash; its rate of turnover of foreign exchange was high, so that large profits could be made on small capital; its funds were available in emergencies, and foreign clients would accommodate it. An investment of funds in a foreign division was, therefore, regarded as "practically analogous to an investment in the highest class of securities," provided the foreign division was conservatively managed.

After American bankers had gained experience in these foreign operations, and junior officers and clerks had learned the business under the tuition of foreigners, and when the foreign business had grown until it constituted a goodly fraction of the total business of the bank, and domestic clients began to use the foreign services extensively, it became less necessary and even awkward to manage the foreign division as a separate debtor institution. Therefore, the departments of the foreign division became and are now largely co-ordinate with those of the domestic division.

The foreign division is an important part of large metropolitan banks, particularly in seaports and financial centers like New York, Philadelphia, and Boston, and in manufacturing and produce centers like Pittsburgh, Chicago, and St. Louis. New York far exceeds other American cities in international banking, and such of its banks as have established foreign correspondents, agencies, and branches, and conduct foreign exchange operations, have very large and highly specialized foreign divisions.

Relatively few banks have developed international banking, what business of this sort comes to those who have no foreign connections being handled through their metropolitan correspondents. The volume of their business is too small to warrant the expense of maintaining foreign agencies and the business is peculiarly technical and difficult and requires special training and equipment. But conditions are rapidly changing; many banks are starting international banking on their own account, and no activities of New York banks are growing so fast as those of the foreign division.

Among the many factors causing this growth are the following:

1. The international financial and commercial operations growing out of the late war, whereby New York has almost eclipsed London as the world's financial center.
2. The unprecedented expansion of our foreign trade, particularly during the war.
3. The shift, even before the war, in the character of our exports, from food products and raw materials to manufactured products, the marketing and banking problems connected with manufactures being much more complex and diverse.
4. The spirited and concerted efforts of certain producers, exporters, and bankers to invade the foreign field.
5. The increase in traveling by Americans abroad and in immigration.
6. The greater banking powers conferred upon national banks by the Federal Reserve Act, such as the right to establish foreign branches and agencies, to accept time bills of exchange, and to rediscount bills with the federal reserve banks.
7. The growth of the New York discount market.

The Management—The Comptroller

The organization of the foreign division varies widely with different banks and in most of them is undergoing changes to meet the needs of rapid expansion. The volume of business is probably the greatest factor in determining the form of organization and the specialization of functions. The work of a foreign division can best be made clear by describing the organization and departmentalization as of a large New York bank which, it may be assumed, has long engaged in international banking and has developed a voluminous business. Such an organization is shown in the accompanying chart (Figure 36), which is designed to bring out the relations here described and does not purport to be the organization of any particular bank. To see the relations

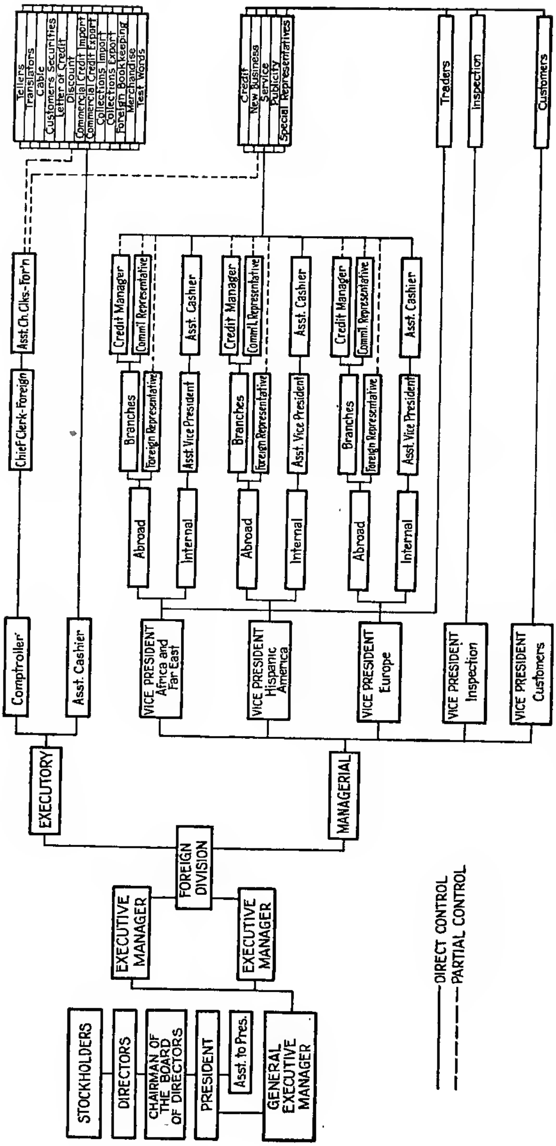

Figure 36. Ideal Chart of a Foreign Division

between the management of the foreign and the domestic divisions this chart should also be compared with the larger chart (Figure 10) given in Volume III, pages 538 and 539.

The foreign division is shown to be under the general administration of two executive managers of the bank. These are senior vice-presidents. Immediately subordinate to them are several vice-presidents of the junior rank on the managerial side, and the comptroller or, in case the bank has no comptroller, the foreign chief clerk and the assistant cashier on the executory side.

The comptroller is presumably an expert in organization work, versed in the duties and activities of every department; either he has risen from the ranks and acquired his training by service in the various departments, or else he has been called into the bank because of his organizing abilities as proved in other lines of business. He is the ultimate determiner and adjuster of any question about the internal organization of any or all the departments and of the method of handling any item. He delegates this part of his work to the chief clerk, to whom the departments are directly responsible in all matters of detail. The chief clerk has entire charge of the personnel of all departments, and all questions of hire, salary, discharge, and nature of employment are handled by him. The chief clerk is co-ordinate with the assistant cashier and they co-operate closely and together oversee the many departments. In banks which do not have a comptroller, the chief clerk is in direct charge of the work.

The Chief Clerk and the Assistant Cashier

The work of the office of the chief clerk is divided among the following:

1. Test-word clerks, whose duty is to check the test words which authenticate outgoing and incoming cables pertaining to many transfers and payments.
2. Per procuration clerks, who are authorized by the directors to sign mail, drafts, and other items on behalf of

the bank, and who as a matter of convenience have their desks in the departments where they are most needed.

3. Assistant clerks, who help the chief clerk to devise methods and routings for handling regular items, to determine and direct the procedure in handling irregular items, and to locate mistakes and errors, devising a better system if they find errors to be due to faulty organization, and training the clerk at fault or finding a more competent employee if the mistake is due to the personnel of the department.
4. A special reports clerk, who, under the direction of the chief clerk, prepares special reports on a variety of subjects pertaining to the foreign division for the use of the officers of the bank.
5. An information clerk, in charge of the public information desk and the bench boys who fetch and deliver all sorts of messages throughout the bank.

The executive of the foreign division is an assistant cashier. To him all questions on foreign exchange or other operations arising in any of the departments are directly referred by the department head. He is presumably an expert in the subject of foreign exchange in all its bearings. His training has been largely acquired in actual operations in the traders' and other departments. He is the ultimate determiner and adjuster of any question on these subjects, and he bears the responsibility for the successful execution of the policy of the management. In certain banks the heavy responsibility of the traders' department has made it expedient to put that department, along with the credit, new business, service, publicity, and special representatives' departments, directly under the management of one or more vice-presidents. In such an organization the assistant cashier works under the immediate direction of one or more vice-presidents who are expert in foreign exchange.

The Vice-Presidents

The managerial side of the administration of the foreign division is in charge of several vice-presidents and consists of two divisions, one geographical and the other functional. The foreign world is divided geographically on the basis of contiguity or general likeness of business, and one vice-president is given exclusive charge of an area. Each of these officers specializes in the social, political, fiscal, financial, and commercial affairs of the region assigned to him and becomes an authoritative analyst and interpreter of banking conditions in that part of the world. Because it is within the power of the traders' department to make or lose considerable sums of money and because the traders need the advice of the vice-presidents in control of their respective areas, the traders' department may fittingly be made directly subject to those vice-presidents rather than to the assistant cashier.

The vice-president in charge of an area has two organizations under him, the one at the bank and the one abroad. The internal organization, probably in immediate charge of an assistant vice-president or other officer, handles the sections of the credit, new business, service, publicity, and special representatives' departments that pertain to its respective area. The foreign organization embraces the foreign traveling or resident representatives and the branch banks. The character of the work and organization of branch banks has been described in Volume II, Chapter XVI, and the collection of foreign trade data and credit information in Volumes III, Chapter XXXVIII, and IV, Chapter XLVII, respectively.

Certain of the vice-presidents have functional duties of an administrative kind. One of them meets the foreign customers when they visit the home office, either in person or through their representatives or friends. He is necessarily a linguist, and a part of his aim is to win customers and good-will for the bank. To another vice-president may be delegated the liability inspection work; he travels abroad in the territories where business originates and investigates the credit risks of the bank's present and prospective customers and correspondents. To other vice-presidents may be delegated similar specialized services.

Departmentalization

The foreign division described in this book has been divided into many departments. The departmentalization of banks differs, of course, and some departments, such as purchasing, restaurant, time clerk, etc., are so elementary and so similar to departments in any line of business that it is not deemed expedient to describe them. The names given to departments are not as well standardized in the foreign division as in the domestic division, largely because this division is newer and the character of its work is more diversified and fluctuating.

As the volume of business expands, the departments tend to cleave along natural lines into more specialized departments. For instance, the collection department may be divided into two parts, one handling items payable abroad for domestic or foreign accounts and one handling items payable locally for foreign accounts. The commercial credit department separates into two parts, one to handle import credits and the other export credits, and the mail department into divisions to handle incoming, registered, and outgoing mail. However small the foreign division of the bank may be, the many operations here detailed have to be performed, whether they be handled by a few clerks with composite duties, by specialized clerks with limited groups of duties, or by specialized departments in which the duties of the clerks are still further specialized. The nature and volume of the business is the basis of departmentalization. An exposition of the organization and development of a large and well-organized foreign division will offer the new and growing organization suggestions for the apportionment of their work among clerks and later among departments. The following chapters will describe the internal organization and state the general duties of each of these departments, showing how these duties are apportioned among the clerks, how and why each banking operation is performed, and how authority and responsibility are distributed.

CHAPTER LIV

THE ELEMENTS OF FOREIGN EXCHANGE

Foreign Trade Balance

Foreign trade like domestic trade is, in the long run, barter—the exchange of goods against goods. If more merchandise is sent by the people of the United States to the people of France than is imported from France, the balance of trade with regard to the United States is said to be favorable. Although under mercantilism "favorable" had a fallacious connotation, now when properly used it means simply that, if no other contemporary foreign transactions be considered, after balancing the money value of exports and imports and canceling the debts to that degree, a net indebtedness is owing to the Americans and there is a tendency for gold or other goods to flow to this country. Even though the debt stands for years, the only way America can be satisfactorily compensated is by the French sending an excess of goods directly or indirectly to America. To the degree that gold can be used in America in the arts or to meet the needs of a growing country for a larger stock of money media to handle its trade at the prevailing price level, the gold will be a satisfactory form of goods; but if gold cannot be so used and simply inflates the price level, no advantage accrues to America. The rising price level will soon stop, if it does not reverse, the direction of trade between America and France, for America becomes a poor place for France to buy in and France becomes a poor place for America to sell in. These elementary principles of trade apply equally well to the trade between different parts of the same country.

When between two countries a credit system develops, the debts of importers in one country may be balanced against the credits of the exporters of that country and only the net balance be paid in gold. The debt may be left, of course, to run permanently or until such time as the balance of indebtedness is reversed. Since gold is exported with such reluctance and at some expense, foreign trade is conducted almost wholly by the cancellation of contemporary or serial debts, and the economy of gold is most marked. These debts are bought and sold; an importer, for instance, makes settlement by buying directly or indirectly a credit from an exporter and remitting it to the foreign creditor. The common instrument of debt in foreign trade is the bill of exchange. The term "foreign exchange" means the operations connected with international payments by bills of exchange. These documents are many, complex, and various, and have for centuries been regarded as the mystery of commerce.

The Demand for Bills of Exchange

A bill of exchange is an order by one party on a second to pay to a third. To illustrate the fundamental nature of international payments let us adopt for convenience the following abbreviations:

A, the United States of America
E, England
B, Brazil
Ea, the American exporter
Ia, the American importer
Ba, the American banker
Da, an American firm, person, bank, or discount house which buys and sells bills of exchange in the New York open discount market
Ee, Ie, Be, and De, the corresponding English parties at London
Eb, Ib, and Bb, the corresponding Brazilian parties at Rio Janeiro

Be and Ba may be assumed to be mutual correspondents having accounts with each other, and Bb may have a correspondent in London and New York.

Suppose Ia buys £1,000 value of merchandise from Ee and wishes to make payment. He has the alternative of shipping £1,000 gold or buying a bill of exchange to remit; the former will cost him £1,000 plus expenses; but the American money unit is dollars, the pure gold equivalent of £1,000 being $4,866.50, and the shipping expenses may aggregate, say, $29.50. If he can buy a bill of £1,000 for less than $4,896 it is plainly to his advantage to do so. On the other hand, if a £1,000 bill costs more than $4,896 it is cheaper to ship specie. The price $4,896 is called the "gold export point."

The American importer might by chance find an exporter who has a £1,000 bill for sale, but in all probability he would buy the bill from his bank. The elements of such a bill would be, that Ba orders Be to pay £1,000 to Ee at sight, on demand or after a certain time, depending upon when Ia's debt to Ee is due, and to charge it to Ba's account. Ia would pay Ba, say, $4,893 for the bill, and send it to Ee, who, if it were a sight or demand bill, would collect at once from Be; Be would then write off Ba's account £1,000 and send the voucher to Ba. If, however, it were a time bill, Ee would present it to Be for acceptance; that is, Be writes "accepted," "good," or some other such expression, across its face, and thus obligates himself to pay it at maturity; Be is then the acceptor as well as the drawee and payer, and the bill is known thereafter as an "acceptance." Ee may retain the acceptance until maturity and present it to Be for payment, and Be then writes off Ba's account and sends the voucher to Ba.

In case, however, Ee needs funds at any time between the dates of acceptance and maturity, he may sell the acceptance in the open discount market in London for what he can get. The buyer, De, may be any person, firm, bank, or discount house in London, the provinces, or abroad, who has idle funds seeking temporary investment. It is plain that Ba has the use of $4,893 until his account in London is written off; that Be has advanced no funds of his own until the maturity of the acceptance, and meanwhile Ba has presumably put Be in funds to meet the obligation; and that the real creditor is Ee, provided he did not sell the acceptance, or De if Ee did sell it before maturity. This acceptance, being drawn on a banker, is called a "banker's acceptance," and because of the high credit rating of the drawee commands a good price from De.

It appears, therefore, that importers in the position of Ia are in need of bills of exchange, from either American exporters or bankers. The greater the value of the imports, the greater the demand for bills of exchange in New York on London. At those seasons of the year when importations are heaviest the demand for exchange on London may be expected to increase.

Exactly the same series of operations and considerations takes place when for any reason other than importation of merchandise an American has occasion to make payments in England. Such occasions would be to purchase securities in London, to loan funds on the discount market, to increase a balance abroad, to pay interest or dividends to security holders in England, to pay for marine insurance or freight-carrying by English merchantmen, to provide funds in England for travel or sojourn there, to remit funds to relatives or friends in England, and the like. Every such transaction augments the demand side of the market for bills of exchange in New York, and the sum of these individual demands constitutes the market demand for exchange in London.

The Supply of Bills of Exchange

Suppose Ea sells to Ie a bill of goods for £1,000 and wishes to be paid. Until the Great War was well on its way the custom of trade between America and England, in practically all cases, was for the American importer to take the initiative in making payments to his English creditor, and also for the American exporter to take the initiative in getting his pay from his English debtor. Ea would write out a bill of exchange ordering Ie to pay at sight, on demand, or after a certain time, according to the terms of sale of the goods, to the order of some American, say Ba, and to charge same to his account, and then sell this bill to his bank (Ba). The bill might be "clean" or "documentary." Ba would prefer that it be documentary in this case, for it has not yet been accepted by Ie, and Ba has possibly no evidence that Ea is authorized to draw on Ie, and the bill when presented may be dishonored; it then is a single-name paper and its value depends upon the credit of Ea. If, however, documents are attached—consisting of the bill of lading, insurance certificates, etc.—which in case of non-acceptance or payment give Ba title to the goods represented, Ba holds a single-name paper with collateral security, and will therefore, other things being equal, pay a higher price for the documentary bill than for the clean bill.

In such a case, where Ea has £1,000 due him in England, the question arises: Is it more economical for him to sell such bill for a price to Ba, or to cable Ie to ship the £1,000 gold at Ea's expense? If the expense of such shipment is, say, $29.50, the proceeds of the importation of gold would be $4,837. Hence, if Ea can sell his bill for more than $4,837, it would be better than to import the gold. The price $4,837 is called the "gold import point."

Ba, having bought this bill for, say, $4,840, will send it to Be, who will present it at once to Ie for payment if it is a sight or demand bill. If paid by Ie, he writes off £1,000 of his debt to Ea.

The documents may be delivered to Ie at the time of acceptance if it is a documentary acceptance bill, or at the time of payment if it is a documentary payment bill. Upon receipt of documents Ie can get possession of the goods. To deliver the documents upon acceptance leaves Ba (or his agent Be) with an unsecured double-name paper, and is dangerous unless Ie or Ea, or both, are good credit risks.

But an acceptance the documents of which have been removed can be readily sold in the discount market since it is not encumbered by documents, whereas a documentary payment acceptance can be sold only with difficulty since it is necessary that Ie know where the bill can be found if he decides to take it up before maturity. Documentary payment bills are usually taken up before maturity if they cover perishable goods or if the market becomes very favorable for the goods. Interest is usually rebated to Ie, in England at 1 per cent less than the bank rate, and on the continent at the bank rate. This quality of ready marketability of documentary acceptance bills increases their value, and Ea tends, so far as this reason holds, to get a higher price for documentary acceptance bills than for payment bills.

If Ba has Be hold the acceptance until payment or maturity, it is said to be "in depot." Ba may at any time order Be to sell it in the London discount market, thereby increasing his balance with Be, against which he can sell bills in America. As long as Ba or his agent holds the bill, he is creditor to Ea and Ie, but as soon as it is sold to De, Ba puts himself in funds and De becomes the creditor. Since the great majority of export bills drawn are acceptance bills and are sold in the discount market, and the bills used in the import trade are likewise sold in the discount market, it is evident that the persons who really finance foreign trade, the ultimate creditors, are such parties as De or, if De be a bank, the still more ultimate creditors are to a degree the creditors of De

The volume of funds held by all the De's for such investment, and the volume of bills so offered for sale, determine the size of the discount market, the discount rates, and the degree in which their city becomes the money market of the world. The lower the rates of discount, the higher the price goes for bills and the cheaper the cost of financing trade; and the larger and wider the discount market the surer is the buyer or holder of bills of finding a ready, continuous, and steady market for his items, and the safer do such short-time investments become. The banks of any country, having a good discount market naturally, therefore, buy the better forms of rediscountable commercial paper to form their secondary reserve, and divorce themselves from dependence upon long-term corporate securities and the financial market for their second line of defense, a dependence which has characterized the banking system of the United States.

Exporters, like Ea, offer bills for sale. The larger the volume of exports the larger will be the supply of exchange for sale in New York on London. The offers of bills will be made by exporters to bankers who act as middlemen. The bankers, having bought the bills and thus procured credits in London, are in a position to sell exchange at low rates. Exchange may be offered for sale by any party who has money in England due to him. The supply of bills for sale, therefore, is determined by the amount of funds owing to Americans, but the largest part of this is due to exported merchandise, and for that reason the supply is seasonal, varying with the times of exportation. The rest of the supply comes from parties who are selling securities or other investments abroad, who are borrowing abroad by the sale of bills, who are reducing their bank balances abroad with a view to investing at home or to increasing their cash reserves, who own foreign securities or property from which interest, dividends, or rent is received, who are traveling or living in America and draw funds from abroad, who employ the services of Americans in various ways, etc.

The Reciprocal Relation of Exchange Rates in Two Markets

In case Ie takes the initiative in making payment to Ea he will ship gold or buy a bill in London from Be and remit to Ea. If he ships gold, neither the demand for bills in London nor the supply of bills in New York will be increased; the operation will proceed and leave the market for exchange as it was, except in so far as the movement of gold may tend to affect the bank discount rate.

If Ie buys a bill from Be and remits it to Ea, who collects from Ba, then Ba's home funds are reduced but his balance with Be is increased, and Ba is then readier to sell bills on London; the supply of bills, in other words, will be increased, and to the same amount as if Ea had drawn directly on Be. Be, on the other hand, has greater funds in his vaults but his balance with Ba is reduced, and he will now wish to buy bills to remit to Ba for sale and credit to rebuild his balance. The demand for bills in London will increase. A rise in the demand for bills in London means a fall in the demand for bills in New York; the same inverse relation obtains in the supply of bills.

If, therefore, in early autumn, American exports to England increase, bills of exchange in New York on London will be plentiful relative to the demand, or bills of exchange in London on New York will be scarce relative to the demand, or both. In fact the two variations are synchronous and reciprocally reverse.

Fluctuations in the Rate of Exchange

The bidders for bills of exchange in New York would be willing (as above explained) to pay up to $4,896 for a £1,000 bill, but whether they would have to pay that amount would depend upon the relative demand and supply of bills there. If the importation of merchandise or any other event occasioning remittances to England should occur and cause an increase in the demand for bills, the competition among buyers for bills would become more intense and sellers could ask and get more for their bills; the price would, therefore, tend to rise up to, but not normally beyond, the gold export point. At that point those bidders for bills who had not yet bought bills would find it more profitable to export the gold. The situation would not be changed if the English creditor drew on the American debtor and sold his bill to Be, for Be would remit it to Ba for collection and Ba would have to make settlement with Be by sending bills or, if the rate of exchange were above the gold export point, by sending gold.

In the actual practice of business, importers, manufacturers, dealers, etc., rarely do ship gold themselves but continue to buy and send bills, for they have not the knowledge or shipping facilities or a large enough debt to warrant their shipping the gold themselves. The shipping of gold is handled by a few large banks which specialize in foreign exchange, and competition among them keeps the price of bills at or below the gold export point. When the price of bills rises up to this point, one or more of these banks despatch gold to London rather than pay the high prices for bills to remit. Looked at from the supply side, it may also pay some banks, which are not under any necessity of buying bills to send abroad, to ship gold, for they are then in a position to sell bills, at the gold export point at most, to persons having remittances to make, and to undersell their competitors whose foreign balances are nearly or will soon be exhausted. In fact, bankers anticipate such times of high exchange rates and ship the gold in advance of need. This supply of bills keeps the price down to the gold export point or lower.

On the other hand, if exportation or any other event occasioning withdrawals of funds from England should cause an increase in the supply of bills in New York, the exchange market would become a buyers' market and the price of bills would fall until it reached the gold import point; at this point those who had not yet found a buyer for their bills would find it more profitable to import the gold than to sell their bills.

Here, again, it is unusual for exporters, manufacturers, etc., to import gold themselves. They keep on selling their bills to bankers, whose balances in London are increasing as these bills remitted to Be are collected, and among whom competition will keep the price of bills up to the gold import point. As their funds in New York are depleted by purchases of bills and their funds in London are increased by the proceeds of such bills, their ability to keep on buying is defeated unless they import gold; and any banker who does import gold can buy longer and at better rates than his competitor who does not import. Hence competition among banks as buyers of bills will keep the price, under normal conditions, up to the gold import point.

The price of bills (the rate of exchange) will, therefore, in normal times, fluctuate between the gold points. These vary from par by the amount of the cost of shipping specie. "Par" means the mint par; it is the ratio of the amounts of pure metal in the standard coins of the two trading countries. It is variously quoted as $4.8665 per pound sterling, 96.25 cents per four marks, 5.1825 francs per dollar, etc. The gold points are determined from these par rates by adding or subtracting the cost of shipping the par weight of gold; for example: The cost of shipping $4.8665 gold to London is in normal times about 2.5 cents. The export gold point is therefore about 4.89 and the gold import point 4.84. It is also assumed in such calculations that this par weight of gold is a part of a large shipment; otherwise the overhead expense would run much higher per unit.

Cost of Gold Shipments

The expense of exporting or importing gold is made up of the several factors enumerated below:

1. *The Cost of the Gold.* At the Treasury or the federal reserve banks of the United States, pure gold can be bought with lawful money, at constant prices, depending upon its purity, either in bars or coin. Since an ounce troy contains 480 grains, an ounce will make 20.671 gold dollars if it is pure gold, or 18.604 gold dollars if it is .9 fine, and gold of intermediate purities will cost intermediate prices. The size and number of the bars also affect their prices slightly. (See Volume I, Chapter II.) In case the supply of gold bars is exhausted by withdrawals for shipment, the Treasury will supply gold coin, which on account of abrasion will, of course, be handled by weight rather than by count abroad. Since the United States government has free and gratuitous coinage of gold, it has in normal times a free gold market.

In London the price of gold varies. The Bank of England is required by law to buy all the gold offered at £3 17s. 9d. an ounce and it may pay as much more as it sees fit. But since one ounce, when coined, will make £3 17s. 10 1/2d., the highest price the Bank of England would pay, under normal conditions, for pure bar gold would be this unit equivalent, £3 17s. 10 1/2d. The price of pure bar gold would fluctuate, therefore, between £3 17s. 9d., and £3 17s. 10 1/2d., the highest price being paid when the bank had especial need for gold for reserve, export, or other purpose. But when the bank purchases gold with gold coins, many of them are abraded and under weight, and the bank will accordingly pay more than the mint price, £3 17s. 10 1/2d., the coins being within the limit of tolerance in England but acceptable only by weight abroad. If a New York bank, therefore, exports gold to London, unless the price has been guaranteed by someone quoting "to arrive rates," the bank does not know what the value of the gold on arrival will be, whereas the London banker is sure of the price of gold shipped to the United States.

A large proportion of the gold product of the world is produced in the British dominions and flows in the bullion state to London, where it is auctioned each Monday morning to bidders representing home and foreign banks and manufacturers who may be in the market for gold. The bids are determined by the relative needs of the bidders and take into consideration the present and prospective supply on the market. Thus in normal times the gold tends to flow to the bank or country where it is most needed, and its distribution from London and subdistribution and ultimate lodgment will be determined by exchange rates.

2. *Cartage and Packing.* For distant shipment bars are preferable to coins, for the abrasion is less and carting and packing are easier. The packages must be carted from the federal reserve bank or other vaults to the steamer and, on arrival abroad, from the steamer to the bank; many other cartings may

be necessary if the gold is carried to ports other than London. The overhead of these operations is much reduced per unit if the shipment is large.

3. *Freight and Express.* These items vary with the rates and depend on volume, distance, direction, season, carrier, etc. During the war the great demand for shipping raised freight rates to a high figure.

4. *Insurance.* This item varies with the distance, vessel, season, and other factors. It was most seriously affected during the war, and to the regular marine risks were added the high war risks.

5. *Assaying.* When a shipment reaches London it must be tested for purity and weighed; this is a necessary addition to the expense of gold shipments.

6. *Interest.* Suppose a New York bank exports gold to London, drawing a sight draft against the proceeds and selling it the same day the gold is shipped, and that the draft and gold go on the same steamer. Obviously the buyer (remitter) of this draft, paying cash, is deprived of the use of his funds until the draft arrives abroad and is collected from the drawee bank. In normal times this takes about seven days; the buyer might have waited until this seventh day and cabled his remittance, he himself thus enjoying the use of his funds rather than letting the New York bank use them. The sight draft rate should be less than the cable rate by the interest for the seven days. But the gold on arrival goes first to the assay office for assaying and weighing, and the draft will have been presented at least three days before the New York bank is credited for the gold shipped. If the London bank honors the draft, Ba's account is overdrawn three days, and Ba should rightfully pay Be interest for this loan (overdraft) at the London rate. Ba must, therefore, deduct from his cable price to the American buyer the interest for seven days, and must pay Be interest for three days' overdraft. But Ba has the use of the funds in New York for the seven days, hence only the in-

terest on the overdraft should be regarded as part of the expense of exporting gold. If a cable instead of a demand draft is sold the same day the gold is shipped, the interest loss is for a 10-day overdraft.

In case Ba imports gold, he loses the interest on the purchase price for the entire time of transit. Whether Ba instructs Be to buy gold and charge to his account, or instructs Be to sell some of his bills held in depot and buy gold, or remits funds by cable to buy gold, he loses the use of the purchase price until the gold actually arrives in his New York vaults.

Because the different expenses connected with gold shipments vary somewhat from season to season, the gold points must necessarily vary; an increase in insurance rates, freight rates, etc., raises the gold export point and lowers the gold import point. During the war these items rose very high, and unprecedented exchange rates resulted from this among other causes.

In normal times the gold points, as said before, cannot differ from par by more than the cost of shipping specie; but this assumes that there are free markets for gold, wholly free, as in the United States, or nearly free, as in pre-war England, where the price varied within limits. During the war there were no free markets for gold; embargoes were laid for political, financial, and military purposes, on gold shipments by the belligerents and neutrals; and the exchange rate on London was pegged by the British government, through its New York representative buying or selling at a price the exchange needed. French, Italian, and Belgian exchange was also pegged, but less perfectly.

Investment and Speculation in Exchange

Exchange is subject to speculative buying and selling. The price fluctuates from causes not all of which can be definitely determined, but with results that can in part be predicted with more or less accuracy. Exchange can be definitely described in terms known and accepted by exchange dealers, and contracts for future delivery are, therefore, possible. The dealer in exchange may buy exchange at a low price to hold for a high price; or he may sell present holdings of exchange at a high price and plan to repurchase the same later at a lower price; or he may sell for future delivery exchange which he does not hold and plan to buy exchange later at a lower price to cover his contract.

By buying when the rate is low he increases the demand and tends to raise the rate, and by selling when the price is high he increases the supply and tends to lower the rate. The effect, therefore, of time speculation is to stabilize the rate from day to day or season to season. Such speculation also has the effect of decreasing the alternate importation and exportation of gold, because the speculative sales, when exchange rates approach the gold export point, keep the rate below that gold point, and speculative purchases, when exchange rates approach the gold import point, keep the rate above that gold point.

Foreign exchange bankers should be conservative in their speculative operations. In general, banks are forbidden to deal on the commodity and stock exchanges because of the instability and danger their operations would inject into the commercial and financial world. It is possible, however, for bankers to speculate in foreign exchange, and, being free from inhibition or regulation by law, they need to exercise a self-imposed conservatism. Certain of these speculative operations are thoroughly legitimate and desirable.

To buy exchange as a short-time investment and to buy it as a speculation for sale at a higher price later are alike in execution and indistinguishable except as to the motive of the buyer, and even his motive is subject to change. Investments of funds in 60-day or 90-day bills are practically demand loans, for they may be converted into demand bills at very short notice; they are accordingly a very excellent secondary reserve for a bank, for not only are the funds readily available but the bank is earning interest upon them.

Method of Investment in Time Bills

The common method of investment in time bills is as follows: If the interest rate is low in New York but the bank rate and therefore the commercial rate of interest, for substantial reasons, is high, say, in Paris; and if also, on account of large exportations of merchandise by America to France, the supply of documentary acceptance bills in New York on Paris is large and their price low, the investor will buy such 60-day or 90-day bills. These bills are in duplicate; the first are not indorsed by the buyer, but are stamped "For acceptance only," and sent to the Paris correspondent with orders to have them accepted and to hold the "accepted first subject to the call of the indorsed appertaining second." The duplicate documents are then removed from the seconds and sent by next mail to the correspondent to deliver to the drawees of the respective drafts if they have duly accepted the firsts. The seconds are retained by the buyer and stamped "accepted first held by——."

The discounted value paid for the bills, together with commissions paid to the Paris correspondent, and the taxes and the office and postal charges, constitute the cost or investment. To speak with greater strictness, the investment is really the amount that might be realized on this same date of purchase by the sale of demand bills on Paris, of a face amount equivalent to the discounted value (calculated by the quoted "to arrive" discount rate) of the bills on their date of arrival and acceptance in Paris, less the commission and tax charges. This amount represents what the New York investor really puts into the time investment; it may be more than the sum paid outright for the bills, but instead of realizing cash at once and taking this profit he leaves the larger amount in the time investment. His profits above this cost depend upon the amount realized from the bills at or before their maturity.

If the bills are retained till maturity their face value will be credited to his account abroad; about fifteen days before maturity the investor will indorse the seconds and remit them to his Paris correspondent, who holds the firsts subject to call of the indorsed seconds, and at maturity collects and credits the face amount. The seconds may be sent to some party other than the Paris correspondent, for the firsts are subject to call of the seconds, and the Paris correspondent will then have to hand the firsts over to the indorsee.

Profit from Investment in Time Bills

The profit from the investment left thus to run to maturity can be determined as follows: About eight days (as many days as it takes to send the bills to Paris from New York) before maturity, the investor may draw sight drafts on Paris for the face amount of his investment less the commission and tax charges, and sell these in New York. If the demand rate that day is low, the realized value, and of course the profits also, will be low; but if the demand rate is high the profits also will be high. The profits of the investment depend upon the sight rate of exchange, which fluctuates considerably; the investment is therefore more or less speculative. The interest rate earned on the investment may be determined by calculating the rate of the profits on the outlay, the period being from the date of investment until the date of realization by sale of the demand bills. The rate of interest yielded by the investment varies also with the demand rate of exchange.

The investor may realize upon his bills before their maturity, however. If the discount rate in Paris falls and it becomes advantageous to sell at the higher price, he may indorse the seconds and send them with orders to sell and credit his account with the proceeds. In order to be able to take advantage of any sudden drop in the Paris discount rate, it may be advisable for the investor to indorse the seconds shortly after purchase and remit them to a Paris correspondent with instructions to hold subject to cable order. Whether the account is credited at or before maturity, the profit the investor can realize depends upon the rate of exchange at which he can sell in New York demand bills or cables against the credit thus created in Paris. If exchange rates in New York rise, say, ½ per cent between the time of the purchase of the time bills and the sale of the demand bills, he realizes additional profit; but on the other hand, if the exchange rates fall his profits are reduced. A high demand rate will therefore tempt the investor to close out his investment. In other words, the conditions favorable for investment in foreign exchange time bills are: (1) that there be a prospect of the demand exchange rate rising in New York; and (2) that the discount rate be lower in New York than in Paris, and there be a prospect that the Paris rate will not go higher but will fall or that the New York rate will rise. Obviously investments in long-time bills may be and usually are speculations on the drift of the exchange and discount rates. The investor goes long on the market.

Hedging Operations in Foreign Exchange

It is possible for the investor to realize in another way upon his time bills and take advantage of fluctuations in exchange rates. Some time before the maturity of the time bills he can enter into a contract with a party in New York to deliver, at maturity or at a certain time before that maturity, cables or demand bills, respectively, at a certain price. This contract is a sale for future delivery. He might in fact have hedged, when buying the time bills, against fluctuations in the rate of exchange, by engaging on the same day in a contract to deliver at certain dates, in demand bills or cables, the face value of the time bills bought.

A common and legitimate occasion for selling exchange for future delivery arises when a banker, in order to establish or increase his balance abroad, buys 30-day and 60-day documentary payment bills. These instruments are payable at maturity or, under rebatement of interest, at an earlier date, and the banker does not know just when they will actually be paid. To sell demand drafts to an amount equivalent to the face value of these remitted payment bills might result in expensive overdrafts, for the payment bills might not be taken up immediately upon the arrival of the goods. The banker may await advices from his agents as to the dates of payments of the bills, and then sell exchange against the proceeds; or he may sell his own 30-day and 60-day sight bills drawn against the time bills which he bought and remitted; or he may sell his demand drafts for future delivery to an amount equivalent to the proceeds of the bills. To execute this last option he would divide the bills into lots according to the probable dates of payment which his business experience had taught him to expect from the drawees of the bills and the kinds of bills and goods represented. One lot might average, say, 15 days, another 30 days, another 45 days, and another 60 days; and against these lots he would sell contracts to deliver demand exchange after 15, 30, 45, and 60 days, in amounts equivalent to the bills probably taken up after those intervals. By entering into these contracts to deliver demand exchange at a price the bank protects itself against a decline in the selling price of the demand bills which it will draw later.

The problem of realizing on documentary payment bills purchased by the New York bank is also solved in another way. The London or Paris bank or acceptance house usually requires the New York banker who draws on it for acceptance to deposit collateral to protect it and is willing to take these documentary payment bills for such collateral purposes. If the New York banker, having some of these bills abroad, deposits them with the accepting house, he can then draw his long bills against them. It is supposed, of course, that the documentary bills will be collected in such amounts and within such times as will cover the long bills drawn against them. If collected before the maturity date of the long bills, the New York banker will be allowed interest at the retirement rate for the time the payment bills are rebated and interest at the rate allowed on deposits for the remainder of the time. But if not collected by the time the long bills mature, overdrafts will occur.

Where a bank sells contracts to deliver demand exchange at future dates, as described above, the transaction is often one side of a hedging operation; for the bank may have entered that day into a contract to buy demand exchange on certain dates at certain rates, from exporters or others. To execute both the purchase of futures and the sale of futures deliverable on a certain day eliminates altogether the risk from fluctuations in the exchange rate. The most common case when a bank obligates itself to buy demand exchange at a future date is when exporters quote a fixed price to foreign customers for goods to be shipped at a certain date, and in order to arrive at that price have to know in advance just what price they can get for their demand bills at date of shipment. The price quoted to the exporter will depend upon the price the banker can get for his own time bill due at that shipping date, or upon the price at which he can engage to sell his own cable on that date. The purchase will not be made except at a margin of profit, unless other motives enter into the transaction.

In times when exchange rates are fluctuating widely, speculation in exchange becomes prevalent, and the practices common in trading in stocks and produce obtain in trading in foreign money. These speculations include buying and selling for future delivery, buying long and selling short, and dealing in options. Some houses advertise the sale of options on marks, francs, lire, etc. An option is a means of protecting the speculator against excessive losses, at the same time giving him an opportunity for great gains. For a sum paid in advance, the buyer of the option procures the right to buy a certain number of marks or other units at a certain price if he finds it desirable to do so at any time within the period of the option. For instance, say, for $2,500 paid to the exchange house the speculator procures the right to buy 1,000,000 marks at any time during the next six months at 3.5 cents per mark. Whether the price of marks rises or falls in the market, the seller of the option will not ask the buyer for margins, nor does he usually ask for commissions. If the price of marks rises, say, to 8.5 cents, the holder of the option will find it advantageous to use the option; he will purchase the 1,000,000 marks at 3.5 cents and sell at 8.5 cents, his resultant net profits being $50,000, less the $2,500 paid for the option.

An option may also cover the right to sell 1,000,000 marks at 3.5 cents. Then if the price of marks falls below 3.5 the holder of the option will be assured a market at 3.5 cents; if the price falls, say, to 1.5 cents, he can buy 1,000,000 marks at 1.5 cents on the market and sell them straightway under his option at 3.5 cents, his net profits being $20,000, less the $2,500 paid for the option. If the price of marks moves above or below 3.5 cents by more than 0.25 cents, the buyer of the option profits; but if it does not move so widely the seller of the option gains the price of the option.

Triangular Exchange Operations—Arbitrage

The preceding discussion of the determination of exchange rates assumes that the whole trade and all the international transactions of the United States are with England alone, whereas in fact they are with every part of the world. The United States may have a favorable balance of trade and other transactions with certain countries and an unfavorable balance with others, and the net sum of all may be favorable or unfavorable. The adjustment of international payments is effected by both direct and indirect settlements through the instrumentality of bills of exchange, however numerous are the trading countries.

For illustration (still using the preceding symbols), suppose A exported wheat to E, B exported coffee to A, and E exported woolens to B. The bills drawn by Ea on Ie might be sent by Ba to Bb to cover the debt of Ia to Eb, and Bb might send these bills received from Ba to Be to cover the debt of Ib to Ee. The result would be that the greater part of these triple obligations would be settled by the exchange of these bills, and only the net obligation would have to be adjusted by shipping gold or extending a loan.

The scheme is improved if the importers in A, B, and E arrange with Be to let the exporters in those countries draw on it rather than on the importers, and Be agrees to accept and pay at maturity all such bills as are drawn under the agreement. Then if all importers have such arrangements with a single Be, the plan amounts to an international checking system and settlement by book balances. Even if the arrangements are made with several Be's, their obligations may be collected by messenger or clearing house.

If A draws on B in milreis and on E in pounds sterling, the prevailing rates of exchange on these two countries may indicate that the rate of exchange between E and B is out of line, and an exchange operator may take advantage of the situation by selling where exchange is high and buying where it is low. For instance if the rate in A on E is high, while the rate in A on B is low, and if in B the rate on E is low, an arbitrageur in A could buy exchange on B and cable his agent in B to buy exchange on E; this would create him a balance in E against which he can sell exchange in A. By increasing the demand in A for exchange on B and in B for exchange on E, he tends to raise those rates; but by increasing the supply of exchange in A on E he tends to lower the rate in A on E. Such operations are known as "arbitraging" and have the effect of equalizing the rates of exchange and limiting their variations. The chain of operations may cover more than three exchange markets.

Gold exportations are also sometimes of a roundabout nature. If Ba wishes for some reason to establish a balance in Be, and he finds the rates for sterling bills are relatively cheaper in B than in A, but that bills on B are scarce, then, instead of buying bills in A on B to remit to Bb for sale, he finds it better to ship gold to Bb and when the gold arrives in B to order his agent Bb there to buy exchange on E. The bill on E is then sent to Be for sale and credit to Ba's account. The lower the rate at which Bb can buy on E, and the higher the rate at which Ba can sell exchange on Be, the greater the profit from the transactions.

Cable Exchange

Telegraphic transfers, or cables, are telegraphic orders to pay money abroad. They are practically all drawn by banks on their foreign branches or correspondents. They are not strictly bills of exchange but have all the effects of bills, the fundamental difference being that the order is telegraphed rather than written, and payments can therefore be more expeditiously made; for the written order must be delivered by mail, which is affected by marine and war risks, whereas the transmission of cables is not so affected. The cable cannot be used for certain purposes, such as, for instance, the delivery of the documents against payment; and cable charges generally exceed postage on written bills. To reduce cable charges as well as provide a means of authenticating cables, cipher codes are adopted by the bank and its correspondent; some of these are very ingenious, and the code is used for all cabling between the two parties. The first and last words of the message are test words and are known only by one or two trusted employees.

Cables command the highest price of all exchange. Their quick transmission renders them a very useful means of covering sight or time bills on the day of their maturity. In times of suddenly tight money, Wall Street banks may sell their demand bills on London much in excess of their balances in London and with the money received relieve the stringency and get good interest on their loans. About ten days later and just previous to the presentation of their demand bills abroad for payment, the banks will buy cables to cover the demand bills. Or again, if for any reason the price of cables and demand bills gets out of line, that is, if the demand for demand bills on occasion becomes exceptionally strong and raises their price unduly, relative to the price of cables, the bankers will sell their demand bills short, with the expectation of being able to buy cables to cover at approximately the same price at which they sold their demand bills, and during this interim they will have had the use of the funds for nothing.

Sight, Short, and Long Bills

The terms "check" (sometimes spelled "cheque"), "sight draft" (or "bill"), and "demand draft" (or "bill") are used almost interchangeably to mean orders to pay money upon presentation of such orders. They are by far the most common form of bill and the one for which the exchange rate is most commonly quoted. The American recipient of a demand bill can get face value for his bill credited to his account abroad after such time as is required to present it to the drawee, depending upon the speed of the mails and of the collecting agent; in peace times a demand bill on London can be remitted and collected inside seven to nine days. Any New York bank to which a holder offered such a demand bill would, therefore, discount it for that number of days. If the holder was an exporter who drew on his foreign customer and offered the bill for sale, he would have to bear this discount unless he included the interest for these days in the price of the goods sold. The difference between the cable rate and the demand rate, therefore, is the discount for these days. Any New Yorker owing a sum due in London in, say, eight days has the option of buying a demand bill today and giving the bank the use of the funds for the eight days, or waiting until the day of maturity and buying a cable transfer and using the funds for the eight days. It has been shown above that if these two rates differ by more than the interest, some bankers will sell their demand bills short and cover with cables, bringing the rates into line again.

Short bills are bills with not more than 30 days to run, and long bills are bills running over 30 days. The bills may have definite maturities fixed by some such clause as "60 days from date," or the date may be indefinite and be fixed by the date of acceptance, as "60 days after sight," and it is then important that the bill be presented as early as possible for acceptance. Prompt presentment for acceptance not only fixes an early maturity, but also satisfies the legal requirement that due diligence be exercised in the presentment for acceptance, so as to protect drawer and indorsers, if any. The period of the bills is called the "usance" and varies with the custom of trade. The usance for bills representing goods which are highly perishable or subject to the whims of fashion is short. Certain countries allow longer usance than others, and the more distant the country the longer the usance. In general, the usance allowed by the exporter suffices to get the goods to the importer and to permit the importer to sell them and make remittance.

The rates for 30, 40, 50, 60, 90, and 120 day bills differ from the cable rate by the amounts of the discounts for those days. The importer having bought goods due in 60 days has the option of buying today a 60-day bill and remitting it to his creditor, or waiting till the day of maturity and buying a cable transfer. In the former case he would be deprived of the use of his funds 60 days, and the banker would have the use of them. He would, therefore, be unwilling to pay more than the discounted value of the cable rate, and the banker would ask no more. If any of these rates differed from the cable rate by more than the interest, it would pay some banker to sell the time bills short and cover by buying cables; this operation would bring the rates into line again. The rates for the various bills all move together and depend upon the cable rate.

Effect of Discount Rates on Marketing of Bills

In the calculation of the prices of time bills the question arises whether to use the rate of discount prevailing in the drawing or in the drawee country. In general it may be said that competition among banks tends to force the use of the lower discount rate, that is, to force banks to pay the higher price for bills. If the discount rate is higher in the drawing country than in the drawee country, and the drawing exporter offered his long bill for discount in the drawing country, the price, if discounted at the drawing country's rate, would be lower than the price at which the bill would sell in the drawee country; banks in the drawing country would thus realize the difference by buying at the drawing country's low price, remitting the bill to the drawee country, and selling there at the high price. Competition, therefore, among them as purchasers would incline them to pay more than the price if discounted at the higher rate of the drawing country, and to pay approximately the price if discounted at the low rate of the drawee country.

If the discount rate is higher in the drawee country than in the drawing country, the lower price would be in the drawee country. In this case, if the bank in the drawing country buys the bill with the idea of remitting it at once to the drawee country for discount and credit, it cannot afford to pay more than the lower price in the drawee country; but it may buy and hold the bill until maturity and realize its face value abroad. Competition among banks, therefore, will tend to raise the price in the drawing country, and the limit will be the price calculated at the lower discount rate.

This effect of discount rates on the marketing of bills is important, for the market with the lowest rates tends to be the place to which bills drift for sale. The creditor country, since it has a surplus of funds, is most likely to have the lowest rate of discount, and therefore to have the greatest discount market. England and London have, for these and other reasons, been the international clearing house for the world's trade and finance, and New York can hope to supersede London only when she provides a greater discount market and lower discount rates. The practice has been for American banks to remit their bills at once to London for discount and credit, because the prevailing discount rate is usually lower in London than in New York. For the same reason English banks having bills on New York would not send them to New York for sale at the lower prices prevailing there. The want of a broad discount market would also limit such remittances for sale and credit. The English banks tend rather to hold such bills until maturity, either in their own portfolio or that of their American correspondent.

The rate of discount in any market on any day varies for different bills, depending upon several factors, such as the length of time till maturity, the credit title of the drawer and drawee, and the character of the transaction out of which the bill arises. The longer the time till maturity the higher is the discount rate, because the buyer ties up his funds for a longer period and the credit risk is greater.

Clean Bills, Documentary Bills, Trust Receipts, and Bills Drawn Against Securities

The differences between clean and documentary bills, and between documentary payment and acceptance bills, and their uses have been previously explained (page 154). The documentary bill differs from the clean bill in being secured by pledged collateral in addition to the credit of drawer, drawee, and indorsers. Long commercial bills are commonly secured by the shipping or storage documents covering the goods handled; the possession of these papers gives virtual possession of the goods to the holder of the bill, and he is secured so long as he retains the documents and the goods remain intact and marketable. If the documents cover goods such as live animals, the keeping of which incurs expense and depreciation, or highly perishable goods, or fashionable or seasonal goods, the collateral security is less valuable.

The shipping documents usually attached to documentary bills include the following:

1. Export, or "Through," Bills of Lading. These documents are issued by railroad companies carrying goods from interior points to seaports, in conjunction with steamship lines carrying goods from seaports to foreign countries. If the producer or shipper sends his goods to a forwarding company at the seaport, under an inland bill of lading, that company exchanges the inland bill for an ocean bill of lading when it forwards the goods. The bills of lading are generally made out to the order of the shippers and indorsed by them in blank; the holders of such bills of lading are then virtual owners of the goods. Bills of lading are issued in sets (duplicate or triplicate), and the number in the set appears on the face of the bills; the drawer should get the full set so as to secure full ownership of the goods.

2. Certificates of Marine Insurance. It is not necessary to take out insurance on railroad shipments, the law imposing the liability for loss or damage upon the railroad company. But an ocean shipment of goods should be fully covered by marine insurance, either by the drawers or the drawees of the bills of exchange. The insurance is evidenced by a certificate of insurance attached to the draft and bill of lading. Marine insurance companies issue to exporters open policies of insurance, under which the exporter issues the certificates without delay at the time of shipment and advises the insurance company to that effect. The premium is paid periodically. If the insurance is placed by the drawee abroad, because presumably at a lower premium rate, no insurance certificate accompanies the bill of exchange but the shipper or drawer attaches a written statement that the insurance is effected abroad.

3. Shipper's Invoice. This invoice is commonly attached, although it is not essential, to the bill of exchange, or it may be sent direct to the foreign importer or drawee and thus avoid publicity. It contains a list of the goods, their selling price, weights, incidental expenses, terms of sale, etc. Its chief use is to substantiate the character of the commercial trans-

action and the drawer, and thus improve the standing of the bill.

4. Consular Certificates, Inspection Certificates, and Weight Certificates. These certificates are sometimes attached, the requirements varying with the consignee country and with the nature of the goods. The inspection certificate is largely for quarantine purposes, and pertains mostly to meat and animal products.

5. Hypothecation Paper. This document attached to a bill of exchange authorizes the banker buying the bill to sell to best advantage the goods covered by the bill, in case payment is refused. To save clerical labor and postage incurred when such paper is attached to every bill drawn, the drawers may execute a general hypothecation power to apply to all their bills bought by their bankers.

6. War Risk Insurance Certificate. During war a special insurance certificate to cover war risks on shipment is attached.

If the documents are delivered to the drawee upon acceptance, between that date and payment the holder has an unsecured credit; but so long as the holder retains the documents it is impossible for the drawee to get possession of the goods and convert them into cash for the purpose of paying the bill. For the convenience of traders there are various devices by which the documents may be delivered and the holder still retain some protection. The most common of these devices is the delivery of the documents to the drawee against a trust receipt, which, theoretically at least, keeps title to the documents and, therefore, to the goods, but allows the drawee to use them in trust for the drawer; that is, to convert them into cash and pay the bill of exchange. Any other use would constitute a breach of trust, upon which the drawer could assume possession of the money, goods or documents.

Another form of collateral security sometimes attached to bills of exchange is stocks and bonds, and such security is a very high kind. Various occasions arise under which such bills would be drawn. To illustrate, a bond held by an American may soon be due in London. Accordingly the American draws on the English corporation for principal and accrued interest and, attaching bonds and coupons to the bill, sells it, whereupon the buyer forwards the bill and documents to his London agent to deliver against payment. Or a Londoner may order a New York broker to buy some stock; the purchase is made, the stock is attached to a bill drawn by the broker on the Londoner, and the bill is sold in the market to raise money with which to pay for the stock. The buyer of the bill holds the stock till the bill is presented and paid.

Commercial Bills and Bankers' Bills

Bills drawn by a house on one of its branch houses abroad are known as "house" or "agency" bills and are essentially single-name bills. The same is true if the subsidiary is conducted under another name. The buyer of the bill must consider this factor in estimating the credit risk attaching; that is, he should know the financial relationship between drawers and drawees. If the drawer and drawee are distinct and independent concerns the bills are two-name papers. The credit risk is therefore less, for the financial embarrassment of drawer and drawee is not necessarily interdependent, and after acceptance either party may be held by the buyer of the bill.

A single-name bill can be converted into a double-name bill by securing the indorsement thereon (guaranty) of a bank of high standing. National banks in the United States are denied by law the right to guarantee (that is, to become accommodation indorser, for a commission or otherwise) obligations in which they have no direct interest. To secure the higher credit rating afforded to a bill when a banker's name appears upon it, the system of letters of credit (travelers' and commercial) has been devised.

A bill drawn in connection with a foreign trade transaction on another individual or commercial house is called a "commercial bill," and its selling value takes into account the credit ratings of drawer and drawee. Certain houses enjoy a very high credit rating, and their bills command prices nearly equal to prime banker's bills. The credit department of a bank or financial house studies the credit ratings of these parties, and the prices offered for their bills vary with the credit estimates.

A bill drawn on a banker or accepting house is called a "banker's" bill, and is considered prime paper in the discount market because of the high credit rating of the drawee. Importers buy such bills from banks to make remittances. Obviously if exporters could draw on banks rather than merchant houses they could get higher prices for their bills, and thus either realize more from the sale of their goods or be able to offer them abroad at lower prices. To accomplish this purpose the commercial letter of credit has been devised. The importer establishes in a New York or London bank a banker's credit, by which the bank authorizes the exporter to draw on it up to the amount of that credit for goods shipped under certain conditions specified in the authorization. The bank also confirms to the exporter the right to draw as instructed by the importer. The exporter then draws on the bank, attaches the documents, and offers the bill for sale to his local bank. Since he can show the prospective buyer his confirmed authorization to draw on a well-reputed bank, he is able to dispose of the bill at a good price.

Commercial Letters of Credit

There are many types of letters of credit, made to fit special circumstances. Their use may be illustrated by a typical case which assumes that a New York importer takes out a sterling credit through his New York bank in order to import coffee from a Brazilian exporter. The statement may be more conveniently made in terms of the symbols used in the beginning of this chapter (page 1097). The price of the sale of coffee by Eb to Ia depends upon whether Ia can arrange for a banker's credit, and what the conditions of that credit are; if, for instance, Eb is permitted to draw at three rather than six months he will offer to sell the coffee at a lower price, for the shorter the issuance the higher the price he can get for his bill.

Having come to an agreement upon the terms of sale, Ia goes to Ba and procures a commercial letter of credit for which he pays cash or pledges collateral; or another institution may guarantee his obligation to Ba, or Ba may issue the credit for Ia's unsecured obligation. The terms vary with the bank's policy and the credit title of Ia. If Ia is a steady customer of Ba he has probably an established line of credit with the bank, and if his application is within the line, the letter of credit will be speedily granted, for many of the details as to commission charges, etc., will have been previously arranged; otherwise, these matters have to be considered and agreed upon. Ba may authorize Eb to draw on Be, and obligate Be to accept the drafts drawn under the terms of the letter; in this case Be is either a branch of Ba's or has given Ba a power to sign for and legally bind Be. In other cases Ba may have to apply to Be for the privilege of issuing a specific letter of credit. These practices rest upon the standing financial relations of Ba and Be. Anyway, Ba authorizes Eb to draw on Be in sterling at, say, three months' sight, up to a specific amount, for invoice cost of coffee shipped to Ia within, say, one year; Eb is to send to Be advice of the drawing and copies of the bill of lading and invoice, and upon receipt of these papers Be will honor the drafts if properly drawn; the bill of lading is to be issued to the order of the shipper and indorsed in blank. If the letter of credit is to be confirmed Be will confirm to Eb by letter or cable.

Eb will then ship his coffee direct to Ia, send the copies of the bill of lading and invoice to Be, attach the original bill of lading and other documents to the draft, and sell it to Bb. Bb will send it to his London agent, who will present it to Be for acceptance. Be accepts the drafts and removes and keeps the documents. The London agent then has a clean acceptance, which he will hold till maturity or sell in the discount market, in accordance with his instructions from Bb. Be sends the documents, with advice of acceptance, to Ba. Ba will deliver the documents against payment by Ia, or deliver them against a trust receipt created by Ia in New York; and Ia, having got the documents, takes possession of the goods. Before the acceptance is due in London Ba will buy exchange and remit to Be to cover. The party who buys the acceptance in the London discount market is the real creditor for the transactions; Ia does not advance funds, nor does Ba nor Be; after Bb sells his acceptance in London he has a larger balance in London but less in Rio Janeiro, and he is creditor only while the bill is in transit between these cities. Ba and Be are paid commissions for their services; Bb presumably profits by the difference between the cost and selling prices of the bill.

Travelers' Letters of Credit

The subject of travelers' letters of credit has been treated at length in Volume III, Chapter XXXIX, but brief consideration may here be given to its relation to foreign exchange operations. A traveler's letter of credit is a banker's credit established for the convenience of customers traveling abroad, against which the traveler may draw. Ba secures from Be a list of correspondents who act as agents for the payment of Be's traveler's credits, and Ba arranges with as many agents as are willing to become paying agents for travelers' credits which Ba is about to place; to all who agree so to act Ba then sends specimen copies of its letter of credit.

The letter of credit is addressed to Ba's correspondents and all other banks to which it may be presented; it introduces to them the traveler in whose favor it has opened a credit of a certain amount sterling, and whose drafts to that extent on Be it engages will meet with due honor if negotiated within a certain time. Each agent bank cashing such draft for the traveler enters on the letter its name and the amount paid by it. When the sum so paid by all the banks equals the face amount of the letter of credit, the letter is attached to the last draft paid and remitted by the paying bank to the issuing bank.

Since the drawee bank is a well-known institution abroad, and since the traveler has attested authority to draw with assurance of acceptance and a list of agents who will purchase the drafts drawn, he finds little difficulty in providing himself with cash en route. If, for instance, the traveler called on the Madrid correspondent and asked to be paid the equivalent of £100 sterling, the Madrid bank would draw up a sterling draft for £100 and specify thereon that it was drawn under Letter of Credit Number ——, issued by a named bank on a named date. The traveler would be asked to sign the draft, and his signature would be compared with the signature in the letter; if approved, the Madrid bank would then pay the traveler the equivalent of £100 in pesetas and would reimburse itself by sending the draft to Be for collection and credit. As soon as Ba issues a letter of credit it advises Be and sends a specimen of the drawer's signature to be used by Be to determine the genuineness of the drafts purporting to be drawn under the credit. If the drafts are genuine, Be will credit the Madrid bank's account and debit Ba's, and forward the draft to Ba. Upon receipt Ba will reimburse itself according to the terms under which the letter was issued, normally at the selling rate of exchange for banker's demand bills on London plus commission and interest for 30 days at current rates.

Dollar Drafts and Credits

The illustrations given above of commercial and travelers' credits refer to sterling credits, and the drafts drawn under them are assumed to be in sterling. In recent years there has been a marked growth of dollar credits. The drafts drawn under these are dollar drafts, the accepting being done by American banks. The power of national banks to accept drafts drawn on them was first conferred in 1913. Up to that time what small accepting was done was by private bankers, state banks, and trust companies. Dollar exchange and dollar acceptances are developing fast, much to the advantage of American traders. If, for example, Ie has established a dollar credit with Ba, Ea can draw in dollars, thus eliminating fluctuations in exchange rates as a factor to be calculated in the price quoted by Ea to Ie. Ea is sure of his price, as the exchange risk is shifted to Ie. Ia also eliminates one commission charge on a letter of credit, for both Ba and Be draw commissions under the sterling credits, whereas only Ba draws a commission under dollar credits. Still another advantage of dollar credits is that it reduces the number of currency conversions; for instance, if a shipment of coffee be made from Brazil under sterling credits, milreis have to be converted into pounds sterling at a rate of exchange, and sterling into dollars at a rate of exchange, whereas under dollar credits the conversion from milreis is to dollars directly.

Short-Term Loans

Bankers take advantage of cheap money in one market and dear money in another by borrowing in the one and loaning in the other. The operations by which these short-term loans are effected through the foreign exchanges are of two general types: (1) the sterling, franc, or mark loan, and (2) the currency or dollar loan, as they are called.

In loans of the former type the lending bank receives a commission, and the borrower bears the risk of exchange rate fluctuations. Although Be is named the "lending" bank, it will appear below that Be does not lend; the loan is simply effected by means of it. The operation of a sterling loan is as follows: Suppose Be, because money rates are low in London and high in New York, decides to place a loan in New York. Be instructs Ba to draw bills on it for, say, £40,000 at 60 days; the bills are turned over to a brokerage house against good collateral pledged with Ba; the brokerage house sells the bills at their best price, say, $153,200. The buyers, Da, send them to their London agent to have them accepted, and then either hold them till their maturity or sell them to De. Or else the brokerage firm itself sends them to its London agent to have them accepted and then sold directly to De. In either case the actual creditor is De, for neither Ba nor Be have put up any money; both have simply put their names to a credit instrument. The understanding is that Be is to receive a commission of, say, 3/8 per cent, of which Be allows Ba a part, say, 1/8 per cent.

About ten days before the maturity of the 60's the brokerage house hands Ba a demand draft on London for £40,150 (£40,000 plus 3/8 per cent of £40,000 commission), which draft it has to buy at the demand rate prevailing in New York. Meanwhile the brokerage house has had the use of $153,200 for 50 days, and whether or not the sterling loan proves a profitable operation to it depends upon what it has to pay for the demand draft. If the exchange rates have fallen and it can buy a demand draft for $153,500, the use of $153,200 will cost only $300; but if the rates have risen greatly the loan may prove costly. The risk of exchange falls therefore on the American borrower, and the cost of the use of the funds cannot properly be considered as interest. Be and Ba get commissions. Be would prefer loans of this character if it expected a rise of exchange rates. The demand draft is sent by Ba to Be to cover the 60's when they mature, and Ba looks to Be for his share of the commission, $50.

In loans of the currency or dollar type the lending bank bears the risk of exchange rate fluctuations and the borrower receives his loan in dollars. In this type Ba draws, as above, on Be for 60 days for £40,000 but, instead of handing the bills to the borrower, sells them to Da and loans the proceeds to the borrower for about 50 days at the prevailing market money rate. Da sends the bill to London, has it accepted, and sells it to De; and De becomes the real creditor in the transaction, for neither Da nor Ba nor Be is out of any actual funds; Ba has simply loaned what he received for the bill from Da, Da recouped from De, and Be has promised to pay later at maturity. Da was creditor for about 10 days, or until he sold to De. At maturity of the loan Ba will receive its face value from the borrower; about 10 days before maturity of the 60's Ba buys a demand draft for as big an amount sterling as he can get with the money received from the borrower, less Ba's commission. The excess of the face of this draft over £40,000 represents the profits of the loan to Be; of course, if exchange rates have risen greatly, there may be a loss. Be, therefore, prefers currency loans to sterling loans when he expects a fall in exchange rates.

It may appear that, since De is the ultimate creditor in both types of loan, Be may extend operations of this kind indefinitely. In currency loans the risk of exchange fluctuations may restrain Be; but against this risk he may hedge by buying for delivery in 60 days a demand draft, for £40,000. The real restraint comes from the impossibility of selling drafts on Be in the London discount market except at such sacrifice prices as would ruin his credit. If too many loan bills are accepted by him the market becomes suspicious and the Bank of England refuses to rediscount his bills. This puts a limit to further profitable loaning in New York.

Currency and sterling (franc, mark, etc.) loans tend to stabilize exchange rates from season to season and to minimize gold shipments. If surplus funds with low interest rates and low exchange rates prevail in London, but tight money with high interest and exchange rates exists in New York, Be will strive to place currency loans to take advantage both of the present high interest rates and the expected fall of exchange rates in New

York. But this operation itself adds to the present supply of exchange in New York, and will add to the future demand for exchange there when sight bills to cover are bought, and therefore tends to reduce the present high exchange rate and will tend to raise the prospective low rate. The operation is primarily a short sale of exchange in the guise of a loan.

Finance Bills—Stock Exchange Operations

The term "finance bill" is applied to long bills drawn by one banker on another to raise money for the use of one or the other, or of both. Finance bills are said by some writers to differ from loan bills described above, in that loan bills are drawn to raise money to lend to third parties against collateral security. This distinction is not clear-cut; nor does the finance bill differ in appearance from the loan bill. Banker's long bills drawn to recover funds already invested in documentary bills are not commonly classed as finance bills. A finance bill issued and sold in New York makes the New York purchaser finance the operation; but in practice this financing is usually shifted at once by Da to De on the London discount market.

Various conditions lead to the issue of finance bills, the chief among which are stock exchange operations and foreign exchange speculations. By far the greater number are drawn in sterling on London. Finance bills are drawn on branches or correspondents.

Sterling finance bills are long bills drawn by Ba on Be, at such times as Ba wishes to raise money to finance some operation in behalf of himself or of Be or of both. If done on Ba's account alone, Be is paid a fee or commission for accepting such drafts; if done for joint account, the profits from the transaction are divided on a prearranged basis. In any case the bills drawn are sold by Ba to Da, who sends them to London, has them accepted, and either holds them until maturity or sells them to De in the London discount market. The real creditor in this transaction is De. Finance bills are often secured by collateral; whether or not they are so secured, and what securities, if any, are provided, are matters of negotiation between Ba and Be; Be may undertake to accept the drawing of Ba without security because of Ba's high credit rating.

The common occasions for the use of finance bills are enumerated below:

1. Ba may find the difference in interest rates in New York and London to be wide enough to permit borrowing in London and lending in New York and more than cover the incidental expenses. He secures permission from Be to draw long bills, raise the money (which ultimately comes from De), and put out the loan. This operation is similar to the loan bill, except that the loan bill arose through Be's initiative. Ba will likely hedge by buying a contract for the future delivery of demand or cable bills sufficient to cover Be's obligation in the acceptance.

2. Another operation closely related to the above is where Ba draws long bills on Be, sells the bills, and loans the proceeds, not so much, if at all, to take advantage of differences in the market rates of interest in New York and London, as to take advantage of the high rate of exchange then prevailing and promising to fall. By selling the drafts at the high rates today and buying sight or cable exchange later to cover, the difference constitutes profits. This is a short sale of exchange and has the effect of stabilizing exchange rates and minimizing the shipment of gold.

3. Another use of finance bills is to carry securities during a slump in the market. If Ba has bought a block of securities as earning assets, using funds which would otherwise be idle at that time, but later, when he needs the funds for commercial uses, he finds the market for the securities has slumped, a common way of procuring funds to carry the securities is to draw long bills on Be and sell them. If the security market has not improved when these bills mature another batch is issued, the proceeds of which

are used to pay the maturing batch; obviously the new batch must be for a larger amount than the first, since the discounted value of the second must equal the face value of the first. The securities so carried may be used as collateral for the bills. When the security market recovers, the securities may be liquidated and the finance bills retired.

4. Speculative operations on the stock exchanges are often financed through finance bills under joint account. Ba, seeing an opportunity to buy some securities for a rise in price, but having no available funds for the purpose, may induce Be to share in the speculative operation. Ba draws long bills on Be, sells the bills and uses the proceeds to buy the securities. He holds them until the market rises in accordance with his expectations, sells the securities and buys demand or cable exchange to cover the long bills, which meanwhile have been accepted by Be and sold to De. De has been the real creditor. Ba divides the profits, if any, on the operation, with Be. If there is a rise in the price of the securities and a fall in the exchange rates, profits result therefrom; if one or both of these prices move the other way, the profits will be reduced, and even a loss may be suffered.

CHAPTER LV

THE ELEMENTS OF FOREIGN EXCHANGE (Continued)

Foreign Exchange and Discount Markets

A discount market is an assemblage of suppliers and demanders, sellers and buyers of bills of exchange. In business phraseology, the discount market refers more particularly to the buyers and sellers of bills after acceptance by the drawees, who may be persons, firms, banks, or accepting houses. Many of these buyers and sellers buy and sell bills accepted by themselves, or one may buy or sell bills accepted by another. A foreign exchange banker may accept bills, which, after their sale through a broker to a discount house and then to a person, may be bought by the bank acceptor. The foreign exchange and discount markets cannot, therefore, be wholly differentiated. The market for bills drawn in the domestic trade of the country may be intermingled with the market for bills drawn in its foreign trade.

Who constitute the buyers and sellers of the discount market has already been explained in the preceding chapter. The foreign exchange banker has been shown to be an intermediary, a middleman, dealing in foreign exchange. Instead of the importer searching out an exporter who happens to have a bill drawn on the same country for the same amount and usance as he wishes to buy to make remittance to his creditor, he goes to his bank to buy one drawn for the occasion; and likewise the exporters go to the banks rather than to the importers to sell the bills they draw. It is the banker's business to sell exchange in all forms, amounts, and usances, to all demanders, and to buy from all suppliers what they have to sell.

But other parties besides the foreign exchange bankers may buy and sell long bills; in fact acceptances are one of the most usual and desirable investments of banks, and even individuals and firms invest their spare funds in them. If any of these buyers decide to resell part of their purchases, they become suppliers on the market. The rediscounting is largely done through the central bank, such as the Bank of England, or the federal reserve banks. It is the chief function of these banks to act as ultimate demanders, to hold in reserve against need cash funds which may be procured by rediscounting acceptances bought by the joint stock or member banks.

Formerly bills of exchange were traded in on the Stock Exchange of New York; but there is no longer an exchange floor where buyers and sellers of exchange congregate. Most of the buying and selling is now done directly between the New York banks and bankers, who keep in close contact through telephones, runners, and foreign exchange brokers. So close is the contact between members of the financial community that it results in but one exchange rate in the market at one time, and the rate moves by small parallel gradations.

Brokers, Dealers, and Discount Houses

Three other parties in the foreign exchange market play important rôles:

1. The brokers, who execute orders on a commission basis. Their business is to bring suppliers and demanders of exchange together and effect a sale, and the human element in personal salesmanship is their ultimate *raison d'être*. The increasingly close contact between bankers themselves has tended to reduce the need of brokers and the commissions paid to them, and they are being gradually eliminated.

2. The dealers, who handle the foreign exchange business for commercial firms. Being well-known and having much experience, these dealers can execute the foreign exchange operations of an exporter or importer with greater skill and economy than can the less known and less specialized merchandising firm.

3. The discount houses, several of which have been established in New York since 1918, to deal in acceptances and act as distributers in the open discount market, which is evolving. In the New York market there has been little real dealing in bills, that is, buying and selling back and forth, for the bills bought by a bank have generally been remitted at once to London for acceptance, sale, and credit. With the rise of dollar exchange and a broader, steadier, discount market, trading may develop as in London, where discount houses are common and important institutions. To date, the development of the discount market in New York has been seriously checked by numerous factors. (See Volume IV, Chapter L, page 1010.)

The foreign exchange banking of the United States centers in New York; in fact, the Wall Street banks determine the foreign exchange rates which control the exchange operations of the whole country. When exchange rates on London are quoted in interior cities, to the New York foreign exchange rates are added the domestic exchange rates from the interior points. For instance, if domestic exchange on New York City is at a premium of 1/2 per mille in Chicago, and exchange on London is 4.86 in New York, the rate in Chicago on London is 4.86 plus .00243. Every fluctuation in domestic exchange, therefore, changes the foreign quotations in the interior cities. Exchange brokers keep their western clients posted on exchange rate fluctuations through the day. The interior banks buy the commercial bills for goods shipped from their districts, but when they wish to sell their own bills drawn against these commercial bills they sell them mostly in New York. Such sales create New York balances for the interior banks, and such balances are very useful to them in their domestic exchange operations.

Commission Arrangements Between Banks

London has long dominated international banking and exchanges, and by far the larger proportion of our foreign exchange transactions are made with Lombard Street. The continental banks have established branches in London, but American banks, with few exceptions, operate not through branches but through London bank correspondents on a commission basis. The conditions governing such an account are a matter of negotiation between the American and London banks, and the rate of commission charged varies with the volume and nature of the transactions passed through the account—the larger the account the cheaper the rates. Special commission rates are fixed for handling documentary bills (about 1/40 per cent), cashing drafts drawn under travelers' letters of credit (about 1/40 per cent), accepting drafts drawn under commercial letters of credit (about 1/16 per cent per month of usance), confirmation of commercial letters of credit (from 1/8 to 1/20 per cent), accepting long drafts drawn by the American bank (about 1/16 per cent per month of usance), collecting cash and other items, etc.

Another arrangement is for the London bank to charge a flat commission rate on all items debited or on all items credited to the account, and not subject the account to special commission charges except for acceptances. Such rates vary from 1/40 to 1/4 per cent.

Another arrangement is for the American bank to pay a lump sum periodically for the total service; this arrangement makes for simplicity, frees the business from special commission charges, eliminates the clerical work in recording in detail the different commission charges, gives the American bank interest on its full balance, and saves correspondence over petty details. This lump charge varies, of course, with the average volume of business that the account occasions, and is accordingly readjusted from time to time by contract.

The London bank generally allows interest on the cash balance at 1 per cent below the Bank of England rate and charges interest on overdrafts either at 1 per cent above the Bank of

England rate or at this rate. All postage and cable expenses are usually charged to the account.

Another arrangement sometimes made between the two banks is for the American bank to agree to maintain a stipulated average minimum cash balance with the foreign bank, in return for which the latter undertakes to handle the account free from any commission charge; the foreign bank looks to its earnings from the cash balance for compensation. This arrangement ties up part of the American bank's funds, makes them less facile, and may prevent the bank from taking advantage of favorable exchange rates and render these funds unavailable in emergencies.

The London Discount Market

In the London discount market all the necessary factors combine to create the broadest, steadiest, and best market for acceptances. England has long been the greatest creditor nation. The bills spring from all kinds of transactions in all parts of the world, thus assuring a variety to fit all demands and reducing the risk by dispersion over many lines. The amount of funds for such investment is large, comes from all quarters of the earth, and is therefore steady in volume, thus assuring a steady and dependable demand for all the acceptances offered and, with an ordinary demand, a low rate of discount or high price for them. In the London market a call loan rate is quoted on acceptances. The London market is dominated by the commercial rather than financial factor, and discount houses can operate with greater safety. The banks are experienced and conservative, and are carefully observed and supported by the Bank of England. England's vast foreign trade, mercantile marine, colonial empire, and ramifying banking, insurance, and commercial organizations, make London the natural clearing house of the world.

The United States in normal times has been a borrowing country, and her banks drew on London and remitted the bills to London for sale in the discount market there. Only occasionally did the United States have excess idle funds to loan to London; and even when such funds existed our bankers as a rule felt themselves too little versed in foreign exchange to take advantage of the high London interest rates. Besides, London borrowers could not draw bills on New York in dollars to much extent, because (1) the discount market in New York was too small to absorb them, and (2) the national banks were not allowed to accept bills. To be a big factor in foreign exchange it is necessary for the drawee country to have a considerable discount market. The development of a discount market makes it possible to stabilize the bank discount rate, and by means of the discount rate to regulate the import and export of gold.

Discount Rates and Exchange Rates

As previously explained, the rate of discount in a market at any time varies according to the tenor of the bill and the credit title of the drawer and drawee or acceptor. The rate also varies from day to day or season to season, according to the exigencies of the money market; and because the factors influencing the London market do not affect the New York market at the same time or to the same degree, differences of discount rates arise between these markets.

If on occasion the discount rate in New York rises above that in London, foreign bankers request New York bankers to draw on them and loan the funds in New York, and the New York bankers reduce their balances carried abroad. If the New Yorkers draw bills and offer them for sale in New York, the increased supply of bills will cause a decline in the rates of exchange; if the Londoners buy bills to remit to New York, the rate of exchange in London will rise, which means a fall in the rate in New York on London. Thus, however the transfer of funds be made, high interest rates in New York will speedily induce a decline in exchange rates. A sudden rise in New York bank rates causes a decided drop in exchange rates; in panics the rate may go very low.

If, however, the discount rate in New York is lower than in England, New Yorkers will repay a part of their borrowings and will increase their balances carried abroad. To pay off rather than renew the loans and to increase balances in London require that bills be bought to remit. This increased demand will raise exchange rates in New York on London. A sudden fall in New York bank rates precipitates a flight of funds to London and a rise in exchange. In times of depression or political disturbances in the United States, or in times of high discount rates in London, the New York exchange rate will tend to rise and run high.

A higher discount rate in New York than elsewhere brings its own remedy. The rate runs high when the bank's liabilities in proportion to reserves are excessive. The high discount rate discourages offerings of discounts and applications for loans or renewals; it leads to contraction; it also induces the inflow of funds from abroad through bills sold indirectly on the London discount market or through the actual import of gold. The reduction of credits and the increase of reserves reduces the ratio of liabilities to reserves, and the bank is then in a position to loan again. Meanwhile the international price level has been readjusted. The inflow of specie tends to raise the price level in the United States and lower it in England, making England a good place in which to buy and the United States a good place in which to sell; but the contraction of credit by the American banks tends to reduce deposit currency and, therefore, prices. As soon, then, as importations and loaning are begun again by the American banks, exchange rates will tend to rise again. Such is the see-saw of commerce. A similar argument applies when the rate of discount is lower in New York than in London.

The higher the discount rate in London, the smaller will be the proceeds realized from bills remitted for sale there; and since the private discount rate fluctuates from day to day in the London market, any such remitter subjects himself to the risk of loss. To protect himself, the American banker gets the London banks to quote "to arrive" discount rates; that is, rates at which they undertake to discount, on arrival in London, bills remitted by the American bank that day. Obviously this simply shifts the risk of discount rate fluctuations from the American to the English banker. If the American is confident that the discount rate in London will fall below the "to arrive" rate while the bills are in transit, it would not be to his advantage to sell at "to arrive" rates. To quote "to arrive" rates is to offer to buy for future delivery.

Effect of Bank of England Rate on Discount Rates

The discount rate of the Bank of England is a very influential rate, affecting directly or indirectly the money rates of the world. In the normal pre-war times it was fixed by the directors at their regular Thursday meeting, and at no other times except at special meetings called in times of financial disturbance. It is an exceptionally stable rate, and is the minimum rate at which the Bank of England will discount acceptable paper.

The rate of interest allowed by the London joint-stock banks on short-time deposits is 1 1/2 per cent below the bank rate. The rate of interest which London bankers allow on average cash balances of foreign correspondents varies from 1/2 to 1 per cent below this bank rate. The rate of interest charged on cash overdrafts on current accounts is the bank rate, or from 1/2 to 1 per cent higher, as fixed by agreement. The open market discount rate throughout Great Britain, at which the private bankers, the London joint-stock banks, and the discount houses will discount paper for local or foreign account, is from 1/4 to 1/2 per cent below the bank rate. The retirement rate of discount, at which rate interest is rebated on documentary payment bills if paid in advance of maturity, is 1/2 per cent above the rate allowed by London joint-stock banks on short-time deposits, which, as stated, depends on the bank rate.

Since the bank rate fixes these rates, the board of directors has great power in international banking. To raise the bank rate raises the rate of exchange in New York on London and depreciates the value of long bills in New York on London; it checks the withdrawal of gold from the Bank of England by making it unprofitable to sacrifice paper, and thus protects the gold reserve and the security of the whole British banking system; it draws gold or funds to London for deposit in the joint-stock banks or for investment in acceptances; it causes tighter money in New York and, therefore, higher call and time rates, and a declension of security values in the stock exchange, etc.

The Bank of England rate is normally not operative in influencing open market discount rates, or not "effective," as bankers' parlance goes; and the bank may proceed to make it effective. That is, if, because of surplus funds seeking investment, the open discount rate runs for some time lower than the bank rate, and no discounting is done at the bank rate, the Bank of England enters the market and borrows the surplus funds by selling its holdings of paper, and, by increasing the demand for money, raises the open market discount rate until it shows a proper differential from the bank rate. On the other hand, if the open market discount rate continues for some time lower than the bank rate by more than 1/2 per cent, and this difference appears to be justified by market conditions, the directors lower the bank rate to the proper differential. If the open market discount rate rises to or beyond the bank rate, it foreshadows the raising of the bank rate. The rate may also be made effective by selling consols for cash and buying them back "for account" or for future delivery.

The rates of rediscount set by the Federal Reserve Board will probably in time be comparable in importance with the Bank of England rate, but not until our banking system is divorced more from operations in stock and produce exchange loans.

The Control of Gold Movements

The international flow of gold may be controlled:

1. By varying the bank rate of the central bank.
2. By varying the price of gold.
3. By making advances to gold shippers to cover interest on gold in transit.
4. By the use of revolving funds.

The flow may also be controlled by the system of gold embargoes and licensed shipments.

The price of gold may be varied:

1. By changing the brassage charge.
2. By changing the tolerance for error in minting or for abrasion in circulation.
3. By government (or private) purchases at a price in paper or other money above the mint price.
4. By the government refusing to redeem paper money, or subsidiary or other coinage, with gold, except at a premium.

These methods may be illustrated by the practices of England and France.

The Bank of England buys all gold bullion which the owners desire to have converted into coin of the realm; and all deposits of gold at the mint are made by the bank at such times as it needs more coins. The bank pays a varying price for gold bars and foreign coins. The minimum price for gold bars is fixed by law at £3 17s. 9d., for gold 11/12 fine. The maximum price ever paid by the bank is £3 17s. 10 1/2d. The difference between these prices, 1 1/2d., is approximately interest at 3 per cent on £3 17s. 9d. for 20 days, during which period it can presumably be converted into coin.

The bank also both buys and sells foreign gold coins. It quotes a price per ounce of gross weight, without melting or assay.

This price is changed from time to time as the bank finds expedient; but, since the American, French, German, and some other coins average a little less than .9 fine, the minimum price is £3 16s. 3 1/2d. per ounce of those coins, which is nearly 9/10 of £3 17s. 9d. The maximum price paid is about £3 16s. 7d. When the bank sells gold coins it usually asks about £3 16s. 7d.

The Londoner who is buying gold for export may take from the bank either gold bars or gold coins of the country to which they are to be sent. The maximum price which the bank can get for the gold bars 11/12 fine is £3 18s. 1/2d., because if a higher price is demanded the purchaser would demand actual redemption of his notes in legal tender gold coins, the pure gold in which would come within that figure.

London is the great market for the product of the world's gold mines; the gold is auctioned there, domestic and foreign buyers, mostly banks, bidding for it against the Bank of England. The price ranges between £3 17s. 9d. and £3 18s. 1d. Payment is made in money or by check. So long as specie payments are not suspended, this means that gold money or representatives of gold money are offered for gold bullion. The market price is close to the mint price; the market minimum price (£3 17s. 9d.) is below the mint price (£3 17s. 10 1/2d.), because it requires about 20 days from the time of deposit for the coining of the gold; and the bank minimum price practically fixes the market minimum. The maximum market price (£3 18s. 1d.) exceeds the mint price (£3 17s. 10 1/2d.), because the coins, although still within the limit of tolerance, are underweight; the average weight of actual legal tender coins is below the full lawful weight. The average deficiency determined by actual test is approximately 1/4 per cent, or 2d. per £3 17s. 10 1/2d. The maximum price is, therefore, the sum of these, or from £3 18s. 1/2d to £3 18s. 1d.

Obviously the Bank of England can restrain or delay the exportation of gold by simply raising above the mint price the price at which it will sell. Suppose exchange in New York or London stands at the gold import point when gold is selling at a certain price in London. Then if the Bank of England raises the selling price of gold, exchange in New York will have to sink lower to reach the import point. Whether such declension will happen depends upon the market conditions. But up to the limit of the power of the bank to raise the selling price of gold, the bank has an effective check on its exportation.

The bank can also stimulate the importation of gold by raising the buying price for bars or foreign coins. Suppose exchange in New York has risen nearly to the gold export point but market conditions do not suffice to bring it fully to that point. Then the bank can, if it so desires, raise the New York rate above the export point by raising the price at which it will buy gold in London; it is then profitable to export gold to London.

By law 3,100 francs are made from 1 kilogram of gold .9 fine. The mint charges 6.70 francs per kilogram for brassage, and bears the cost of alloy. The mint price is therefore 3,093.30 (or 3,100 − 6.70) francs per kilogram of gold .9 fine, or 3,437 (or 3,093.30 ÷ .9) francs per kilogram of fine gold. The Bank of France buys gold at the mint price. A charge of 1 per cent of the value of the bar is made for a certificate of weight, and 1 franc per bar for a certificate of fineness.

The Bank of France also buys foreign gold coin at a tariff of fineness lower than the legal fineness, and these rates are charged as it sees fit. The limit on such changes in price is reached when it becomes profitable for the owner to have the coins melted, refined, and sold as fine bars at the mint price. When the bank buys gold it pays down 95 per cent of the ascertained value; this is considered a loan and interest is charged at 1 per cent for the time required for coinage; the adjustment of this charge is made when the remaining 5 per cent is paid.

France is on the limping standard, and the law permits the Bank of France to redeem its notes in either gold or silver coins, both of which are unlimited legal tender. A person having notes of the Bank of France and wishing to get gold for export may find the bank unwilling to redeem in French gold coins, but willing to redeem in silver at par and in gold bars or foreign gold coins at a premium. The premium varies but is almost always less then 1 per cent. This premium renders Paris less than a free gold market. The virtues of the French gold premium plan of control over gold imports and exports, as compared with the English plan, are that the French method is more efficacious and that the bank rate of discount can be left stable. However, it is the opinion of banking experts that the French scheme would prove inadequate in London with its great international financial responsibilities.

The movement of gold may also be facilitated by the government or central bank making interest-free advances to cover a shipment. The English, French, and Germans have resorted to this practice occasionally. Such absorption of the interest charge reduces the differential between the mint par and the gold points. If, therefore, exchange in New York on Paris stands just below the gold export point, the offer to Paris bankers by the Bank of France to bear the interest charge on the gold shipment brings the gold export point down to the existing rate, and the gold moves toward Paris.

Another method of controlling the gold movement is through revolving funds. The Reichsbank, for instance, may carry a sizable fund invested in discount paper in the London and Paris markets; these are earning assets and easily convertible. If exchange in London on Berlin falls to the gold import point, the Reichsbank can sell some of its paper holdings in London and with the proceeds buy bills on Berlin. By increasing the demand for mark bills the rate on Berlin would rise above the gold import point and the loss of gold by Berlin be prevented. On the other hand, if the rate in London rises to the gold export point the movement of gold to Berlin can be aided by the Reichsbank buying, or retarded by its selling, bills on Berlin. Operations of this kind may be used to stabilize exchange rates.

The Gold Standard and the Gold Exchange Standard

The above discussion of foreign exchange has proceeded on the assumption that all the trading countries have the gold standard. As a matter of fact there may be several monetary standards in use, namely, the gold, gold exchange, silver, bimetallic, and irredeemable paper standards. The recent war disrupted the monetary systems of belligerents and neutrals, and many countries were forced onto a paper basis.

The money of ultimate redemption in any country is the standard money: the other forms of money circulating are redeemable in the standard money at fixed legal ratios. The only conversion possible for the standard money is to reduce it to bullion. A country having gold or silver, or both gold and silver jointly, for standard money is said to be on or to have, respectively, the gold standard, silver standard, or bimetallic standard. If the circulating money is paper irredeemable in anything, either in name or in fact, the country has a paper standard. A country having a form of currency which is convertible into and from exchange on a gold standard country, at legal rates which are fixed by the government and are quite constant, is said to have the gold exchange standard.

Few, if any, countries are on an absolute gold standard. If gold is in fact the money of ultimate redemption, it must be available for that purpose; it does not suffice to have the law decree it redeemable if the Treasury makes no provision for effecting the redemption. The quantity of gold for which other money is redeemable must be definitely fixed and the Treasury must actually pay out that amount freely. All other forms of money current in the country must be maintained at par with the standard money by keeping them redeemable. Any private holder of gold bullion must have the right of free coinage; and any holder of coins must have the right to reduce the coins to bullion. Any person must have freedom to import or export gold bars or coins unrestrained by law, official regulation, or unofficial pressure.

One or more of these characteristics of an absolute gold standard are lacking in every country.

Gold-Silver Exchanges

The rates of exchange between two countries on the gold standard can fluctuate only between the narrow limits of the gold points. The silver points exert the same restraint on the fluctuations of exchange rates between two countries on the silver standard. But the gold-gold and silver-silver exchanges are quite constant as compared with the gold-silver exchanges, i.e., the exchanges between a country on the gold standard and a country on the silver standard. In the gold standard country silver bullion is a commodity whose price in gold is fluctuating with every circumstance of the market, and the gold-silver exchanges show equal instability.

Assume that S is a country on the silver standard and G a country on the gold standard. The exchange rate will depend upon the ratio of values of silver and gold in the bullion markets. The limits of exchange rates are still the costs of shipping specie. Exchange in S on G cannot exceed the cost of gold in terms of silver, plus the cost of shipment; nor can exchange in G on S exceed the cost of silver in terms of gold, plus the cost of shipment.

An exporter in G, in quoting a selling price for merchandise in S, must note the fact that his agent in S will be paid in silver, and in order to remit will purchase, with the silver, gold exchange on G. If the price of silver at this time is low in terms of gold, the face value of the draft obtained will be small; that is, the amount realized by the exporter from his merchandise will be low. Obviously two alternatives are open to him: one is to ask a higher price for his merchandise, the other is to quote his selling price in gold payable in G. If he chooses to quote the higher price payable in the currency of S, he must decide whether the value of silver in terms of gold is likely to rise or fall within the period of the sale. If it seems that it will fall, he can protect himself by asking a price high enough to compensate for silver's lower purchasing power over gold exchange in G; but if he believes the value of silver will rise, he can lower the price of his merchandise accordingly. In either case he will probably be cautious and, if competition among exporters permits, will ask a price that will more than protect him. This throws the cost of the risk of exchange on S.

If the exporter chooses to quote his price in gold payable in G, the importer in S must buy gold exchange to remit. If the value of silver in terms of gold is low, the rate of exchange will be proportionally high. The risk of exchange in this case is likewise borne by S.

If silver tended to decline in value, the effect would be to check the import trade of S but to stimulate the export trade. The rising prices asked in G would hurt importation into S. The products of S sold in G would yield gold funds, against which exchange could be sold in S at rising rates; as the value of silver fell the exporters of S would get a larger amount of the currency of S for their products. If local wages and other costs of production did not rise as fast as exchange rates, the export trade in S would be in an advantageous position. On the other hand, if the value of silver tended to rise, the import trade would be stimulated, for silver currency would command an increasing amount of gold exchange and purchasing power in G.

The instability of the price of silver, and the consequent instability of exchange, make international financial business in gold-silver exchange very speculative. The exporters and importers can largely shift this risk element, at a cost, however, by the use of forward contracts, hedging, etc., in the silver market.

Besides the importers in S, all other parties who have payments to make in G are penalized by the fall in the value of silver and the consequent rise in exchange rates in S. Taxes paid by the people in S to G would cost S more; people of G who live in S and remit part of their earnings home suffer.

The Gold Exchange Standard

To correct these adverse conditions in gold-silver exchange, the gold exchange standard has been devised. It has been employed in India, the Straits Settlements, the Philippines, etc.

Under the gold exchange standard the free coinage of silver in S is stopped; what further silver coinage occurs is done on government account. A legal ratio is established at which silver is a legal tender along with gold. The plan is to starve S for currency for a time by stopping the coining of silver, while the population and trade grow and the demand for money increases until the value of the silver coins exceeds the value of their silver contents and depends upon its power to buy exchange on G. This will keep the silver coins from the melting pot.

The plan also includes the establishment of a gold standard reserve fund kept in G, for the redemption of silver currency in S in drafts on G, that is, in gold laid down in G. The fund may be built up from the seigniorage derived by the government of S from its silver coinage. This fund may be kept in G, as ear-marked gold in the central bank or treasury of G, or invested in securities and short-time loans, or placed on deposit in certain joint-stock banks. The fund must be kept in liquid form.

Against this fund the government in S stands ready to sell exchange on G at a price equivalent to the gold export point, as closely as it can be determined in advance. In G the authorized agent of S stands ready to sell exchange on S at the gold export point. When exchange rates in S rise to the gold export point, the government, in exchange for silver coins, gives the would-be currency exporter of S a draft on G, and charges him simply what it would cost him to ship that amount of gold were he to export gold bars. This prevents the exportation of gold; it removes from circulation in S an amount of the redundant silver coins equal to the purchase price; and the very scarcity of money then tends to lower exchange rates. On the other hand when exchange in G on S reaches the gold export point, the authorized agent of S in G, in exchange for currency of G paid into the gold standard reserve fund there, gives to the would-be exporter of gold from G drafts on S payable in S in silver, the price asked being simply enough to cover the cost of shipment were he to export so much gold. When these drafts are cashed in S an equivalent amount of silver currency is put into circulation. Except when exchange reaches one of the gold points, the government has nothing to do with the exchange business.

Under the gold exchange standard there is no gold circulating in S nor a gold reserve there; yet the currency supply is adjusted quite automatically to the demands of trade without the necessity of withdrawing gold from and injecting it into circulation or of shipping it between G and S. The system provides a gold standard in a silver country without a gold currency.

Exchange and the Paper Standard

Assume a country G on the gold standard and a country P on the irredeemable paper standard. P has probably reached the paper basis through excessive issues of government or bank notes. The process is accompanied by an inflation of prices, making it a good country for G to sell in, but a bad one to buy in; the result is a net excess of indebtedness in favor of G and the consequent expulsion of gold from P to G. The flow of gold from P to G checks the rise of prices and further depreciation of paper in P, and raises the price level in G. When this gold is dispersed to third countries by G it tends to lower prices again in G and to raise them elsewhere. The general level of prices is raised throughout the world when any trading country inflates its currency.

In the process of expulsion of gold from P to G, there appears a premium on gold; that is, gold commands more than its face value of paper. Every person in P who has payments to make in G has the option of buying a bill of exchange on G or buying gold for shipment; in both cases he would use paper money, and therefore the price of exchange tends to vary with the premium on gold in the general market. If the gold-gold rate of exchange, caused by the ordinary shifts in the balance of trade, were k and the premium of gold were 50 per cent, the paper-gold rate of exchange would approximate 1.5 k. As inflation progresses and the premium rises, the rate of exchange in P on G increases, and the rate in G on P decreases. In P the rate of exchange could not much exceed in paper money the cost of buying gold plus the cost of shipping the gold. In G the rate of exchange could not exceed the amount of gold (plus its shipping charges) which it would take to buy paper in P; the higher the premium on gold in P, the lower would be the exchange rate in G on P.

The gold-gold rate of exchange is subject to the narrow fluctuations between the gold points; but there are no limits to the premium on gold and the fluctuations caused by it in the rate of exchange; consequently, the gold premium is the more important influence on paper-gold exchange rates. The rate of exchange is therefore a sensitive index of inflation and depreciation of money. However, it must be remembered that the gold-gold rate may decline simultaneously with an increase in the gold premium, and the resultant increase in the paper-gold exchange rate be less than the increase in the gold premium. The rate of paper-gold exchange fluctuates much and widely, and speculation develops both in gold and in exchange.

The premium on gold (and, therefore, the rate of paper-gold exchange) does not bear an exact correspondence to the inflation of prices. The premium is more sensitive, its fluctuations are more sudden and wide, and speculative influences more readily affect it, in the narrow markets of gold and exchange. The index level of prices moves more slowly because additional money can affect prices only by actual trading in goods and services in the broad national market. When the gold premium is higher than the rise in prices, exports are stimulated, for by selling merchandise and getting gold exchange the difference can be realized in paper money. The prices of goods for export tend to rise. However, if the gold premium is lower than the rise of prices, imports are stimulated, for the importer can pay for his goods more easily. The degree of stimulus to exportation or importation depends upon the degree of discrepancy between price inflation and gold premium.

When exchange in G on P is falling or augurs a fall through further inflation in P or other cause, the present rate of exchange will anticipate the fall and be unduly low, especially on long bills; the buyers of the bills expect to realize less purchasing power in P, and protect themselves by offering to pay less than they hope to realize; the sellers of bills expect to be able later to cover at a lower rate, and are therefore willing to sell at low rates. Importers in G will find it easier to pay for imported goods; exporters in P will realize an increasing amount from the sale of their bills on G; hence the exports from P to G will tend to increase. On the other hand, exporters in G will realize less and less on their bills on P, and the importers in P will find it harder to pay their bills on G; hence exports from G to P will decrease.

If gold is the means of settling final balances in payments between two countries on a paper basis, the rate of exchange in P1 on P2 depends on the ratio of the value of gold in the paper currency of P1 to its value in the paper currency of P2. It will be increased either by further inflation (and consequent depreciation) in P1 or by deflation (and consequent appreciation) in P2. The gold export point will then be reached when for a sum of paper money in P1 a person can buy gold and pay its shipping charges, and sell the gold in P2 for paper money there, and realize more than he can by buying a bill of exchange in P1 on P2.

Exchange and Specie Embargoes

In time of war the people of belligerent nations are often prohibited, not only from trading with the enemy, but also from shipping any specie whatever out of the country to allies or neutrals, except by express permission of the government. The purposes are: (1) to keep the specie for reserve purposes against the probable paper inflation arising in war finance, and (2) to prevent the specie from getting to the enemy through allies or neutrals, and strengthening his finances and therefore his political and military positions. The enforcement of this law requires great vigilance on the part of the authorities, high patriotism of the nationals, the prohibition of silver and gold manufactures which might be used to evade the law, and severe penalties for its infractions.

Such embargoes defeat the control of the gold points over the fluctuations of exchange rates. Under usual conditions of free international movement of gold the exchange rates cannot rise or fall much farther from the mint par than the cost of shipping gold; a wider fluctuation occasions the shipment of gold, which affects the supply of or demand for bills of exchange. But under the embargo on gold shipments the exchange rates move through a wide range. The practical limitation on the upward or downward swing of the rates is simply that the rates arrive at such a figure as will make it profitable enough for someone to undertake a merchandise loan or other operation which will create a supply of or demand for bills of exchange.

For instance, suppose two countries, E1 and E2, have embargoes on the exportation of gold to one another. Suppose the exports of merchandise from E1 to E2 far exceed the imports from E2 to E1, and a balance of indebtedness is due E1. The excess of bills of exchange in E1 on E2 finds no market, the offering rate declines, and the export trade slumps. But as the rate declines the inducement grows for merchandise importers in E1 to buy up bills on E2 and use them to procure goods from E2. Such purchases and importations increase the demand for exchange and check the fall of the rate. The exporters will also appeal to the banks and government in E1 to loan freely to support the export trade and the industries that depend upon the export trade. Such support means the creation of demand for bills of exchange and the raising of the rate. This loan policy of supporting the exchanges cannot be continued indefinitely.

If the government of E2 is under military necessity to buy heavily from E1, it may deem it advisable, in the light of the high exchange rates in E2 on E1, to float some securities in E1 and thus raise funds there, and instruct its financial agent to buy at a certain price all the exchange on E2 which is offered; the exchange will then be pegged at that rate, which is above the market rate that would otherwise prevail. During the recent war the United States government borrowed from its citizens by bond issues, and then loaned to its allies approximately $10 billion; the allies used this sum to purchase products in the United States and cover exchange arising from shipments. The loans to the allies supported the demand side of the exchange market against the supply created by exports. Obviously, so long as American credits are forthcoming, either from the government or from private citizens, exchange rates will be supported against the fall that the excess of exports tends to engender. If the balance of trade is reversed, the excess of imports will tend to raise exchange rates.

Quotation of Exchange Rates

An exchange rate is an expression of equivalence of mint or market values of the currencies of two countries. This equivalence is expressed in three ways:

1. To state the rate in terms of premium or discount. It is the common method employed in domestic exchange inside the United States and as between the United States and Canada, and may be readily adopted between countries having the same monetary unit, as between France and Switzerland, or between England and South Africa, or between the United States and

Cuba. When it requires $1,000.25 in Chicago to procure $1,000 in New Orleans, exchange in Chicago is said to be at a premium of 25 cents; on the other hand, $999.80 in Chicago may procure $1,000 in New York, and then exchange in Chicago on New York is quoted at a discount of 20 cents. The premium or discount may also be stated as a per cent; thus exchange in New York on Havana may be 3/16 per cent premium.

2. To state the number of units of a foreign currency which may be procured or sold for one unit of domestic currency. Thus $1 in New York may on a certain day buy £.25 in London, 6.14 francs in Paris, 4.73 marks in Berlin, etc. This has been the customary method of quoting franc and lira exchange. Obviously, when in New York $1 will buy more than 6.14 francs, the rate in New York on Paris has fallen.

3. To state the number of home units of money that can be procured for one (or more) units of a foreign currency. Thus the above rates may be translated to read that £1 sterling is equivalent to $4, one franc to 16.28 cents, 4 marks to 84.5 cents, etc. Under this method, when in New York one franc costs more than 16.28 cents, exchange has risen.

Which of the methods of quotation is used in any market in quoting a rate on a particular country is entirely a matter of custom. In a large market rates are quoted by each method. There are no logical reasons for the differences, except that for possibly some good cause the initial quotation was made as it was and the inertia of business custom has proved too great thereafter to allow conformity. The variety of method in quotation adds to the difficulties of the novice in foreign exchange.

Variety in quotation also arises from the size of the gradation by which a rate is lowered or raised. The method of quotation has been further complicated by the fact that, with the improved means of communication and the larger size of transaction, and with the greater intensity of competition in foreign exchange, it has become the practice to shade the rates by fractional percentages, either as additions or subtractions.

The rates commonly quoted are those obtaining when the market opens and closes, and the highest and lowest for the day, week, or other period. In quoting the opening or closing rate, the asked and bid prices are stated, as "4.8725 to 4.8730" for sterling. Rates are quoted for cables, bankers' demand, 60-day, and 90-day bills, and for commercial bills. Unless otherwise specified, the business and financial world understands that the rate for banker's demand bills or checks is meant when the exchange rate is stated.

Quotation of Sterling Exchange

The table of English money is as follows:

1 pound	=	20 shillings =	240 pence	=	960 farthings	
		1 shilling =	12 "	=	48	"
			1 penny	=	4	"

As the English monetary system is not founded upon the decimal system, it is necessary to quote it in terms of pounds, shillings, and pence, as £10 9s. 7d., or else reduce the expression to a decimal of a pound sterling, as £10.479.

The unit of English money is the pound sterling, weighing 127.27447 grains troy of gold 11/12 fine, or 113.00159 grains of fine gold. The mint par of exchange between Great Britain and the United States is $4.866564; this is the ratio of the weights of fine gold prescribed by law in the two countries for their monetary unit.

Two scales of intervals are in use in New York in quoting sterling exchange. The older scale is by intervals of 1/8 of a cent, and exchange moves up and down the scale of 4.87 1/2, 4.87 5/8, 4.87 3/4, etc.; on this scale a "point" means 1 cent. The more recent scale is by intervals of 5/100 of a cent, and a point is 1/100 of a cent; exchange moves up and down the scale of 4.8750, 4.8755, 4.8760, 4.8765, etc.

Quotation of Franc and Lira Exchange

The French, Belgian, Swiss, and Italian monetary systems are a product of the Latin Union. They are based on the decimal system. The unit in the first three countries is the franc, and the hundredth part of a franc is called "centime." The Italian unit is the lira, and it contains the same amount of gold as the franc. The franc weighs .32258 grams of gold .9 fine, or .290322 grams of fine gold. It was customary in New York until July, 1920, to quote the franc exchange as so many francs for $1. On that style of quotation the mint par is 5.1826 francs. The common interval of the scale for quoting franc exchange was 5/8 of a centime; the rate moved up and down the scale of 5.16 1/4, 5.16 7/8, 5.17 1/2, 5.18 1/8, 5.18 3/4, 5.19 3/8, 5.20, etc. Of course, the higher this figure becomes the lower is the exchange in New York on Paris. This interval was not rigidly followed, however.

Competition in recent years forced exchange dealers to state the rates by smaller intervals than 5/8 of a centime. They accordingly adopted a very awkward expedient of adding to the main rate a supplemental fraction, plus or minus 1/16, 1/32, or 1/64. Quotations then appeared like the following: "5.18 3/4 less 1/16," and "5.17 1/2 plus 1/32." The fraction was not a fraction of a centime; the fraction "less 1/16" meant 1/16 of 1 per cent of the price of the bill computed at 5.18 3/4; and the buyer was to pay for the bill calculated at 5.18 3/4 and receive a rebate of 1/16 of 1 per cent of that amount. The fraction "plus 1/32" meant that the buyer was to pay for the bill calculated at 5.17 1/2 and an additional amount of 1/32 of 1 per cent of the price so calculated.

Thus if a person bought 33,200 francs at 5.18 3/4 less 1/16, they cost him

$$(33{,}200 \div 5.18\ 3/4) - \frac{33{,}200 \div 5.18\ 3/4}{16 \times 100} =$$

$$6{,}400 - 4 = \$6{,}396$$

It will be observed that this price lies not between 5.18 3/4 and 5.18 1/8, but between 5.18 3/4 and 5.19 3/8.

On the other hand, if the person bought 41,400 francs at 5.17 1/2 plus 1/32, they would cost him

$$(41{,}400 \div 5.17\ 1/2) + \frac{41{,}400 \div 5.17\ 1/2}{32 \times 100} =$$

$$8{,}000 + 2.50 = \$8{,}002.50$$

This price lies not between 5.17 1/2 and 5.18 1/8, but between 5.17 1/2 and 5.16 7/8.

The indirect method of quotation and the use of the supplemental fractions made the quotations on the Latin Union countries very puzzling. Exchange was falling when, for instance, the rate moved from 5.17 1/2 + 1/16 to 5.18 1/8 − 1/16, or from 5.18 1/8 − 1/32 to 5.18 1/8 − 1/16. The simplification of the method of quoting exchange on these countries, and reduction of all quotations to the direct method of so many cents per foreign unit, had long seemed the logical thing to do, but it was not until July 15, 1920, that the plan was adopted in New York. Since that date, exchange on Paris and Milan has been quoted as so many cents per franc or lira, and the mint par is 19.3 cents per franc or lira.

Quotation of Mark Exchange

The unit of the German monetary system is the Reichsmark, or "mark," as it is generally called. It weighs .398274 grams of gold .9 fine. The system is based on the decimal notation; the hundredth part of the mark is called a "pfennig." The mint par is 23.8 cents per mark.

The common method of quotation in New York was, until recently, so many cents per 4 marks. The interval of the scale of quotation was 1/16 of a cent, and the scale ran, 95, 95 1/16, 95 1/8, 95 3/16, etc. The method of supplemental percentages was also used in mark exchange, to shade the rate by amounts smaller than 1/16 of a cent. The percentages used were 1/32, 1/64, etc., of 1 per cent.

For example, if a person bought 4,000 marks at 95 3/4 less 1/32, they would cost him

$$\frac{4{,}000 \times 95\ 3/4}{4} - \frac{\dfrac{4{,}000 \times .9575}{4}}{100 \times 32} =$$

$$9{,}575 - 2.99 = \$9{,}572.01$$

This price lies between 95 3/4 and 95 11/16.

If the person bought 4,000 marks at 95 1/8 + 1/64 they would cost him

$$\frac{4{,}000 \times 95\ 1/8}{4} + \frac{\dfrac{4{,}000 \times .95125}{4}}{100 \times 64} =$$

$$9{,}512.50 + 1.49 = \$9{,}513.99$$

This price lies between 95 1/8 and 95 3/16.

During the recent war exchange operations with Germany were illegal; trading in marks was resumed on July 15, 1919, and thereafter the rates sank very low. The New York houses also adopted the method of quoting marks at so many cents per mark rather than per 4 marks. The great instability of franc and mark exchange has stopped the shading of rates by very small fractional intervals.

The quoted exchange rates are classed as "posted" or "nominal" rates and "actual" rates. The posted rate is the preliminary asking rate for the day before an actual rate is made by the banking house; and it is the rate at which the house sells demand exchange that day in small lots. The actual rate is the rate at which exchange is bought and sold in large amounts between dealers. Nominal rate sometimes connotes a rate for a market which is so inactive as to exist practically only in name. The posted rates are higher than the actual rates and fluctuate less. The posted rates on any day may differ slightly as among the banking houses, but in the actual rates such differences are practically impossible.

Recent History of the Foreign Exchanges—The Inflation Factor

The recent war wrought havoc with the accustomed even tenor of the foreign exchanges. The accompanying chart (Figure 37) indicates the extent of the deviation of rates from the mint pars. The silver exchanges on Shanghai and Bombay went to the highest premiums, and exchange on several neutrals, represented here by exchange on Madrid, also went to high premiums. The exchanges on Germany, Austria, and Russia sank to the lowest discounts.

This dispersion started while the gold standard was still operating, during the earlier years of the war, but became more pronounced as gold embargoes were laid and as inflation of government and bank notes grew in many countries. The gold points were separated from the mint pars by a much wider interval than in the past; this was due:

1. To the higher cost of ocean transportation, the freight rates having risen to unprecedented heights.
2. To the rise in insurance rates, particularly those on shipments through the submarine zone.
3. To the greater interest charges that sprang from the higher interest rates and the longer period of transit.
4. To the increased cost of trucking, packing, etc.

The gold points became ineffective restraints on the dispersion of rates, however, after the foreign exchanges were put under government regulation and the gold standard broke down. There was no longer free redemption, free coinage, or free market for gold. A general suspension of specie payments occurred in

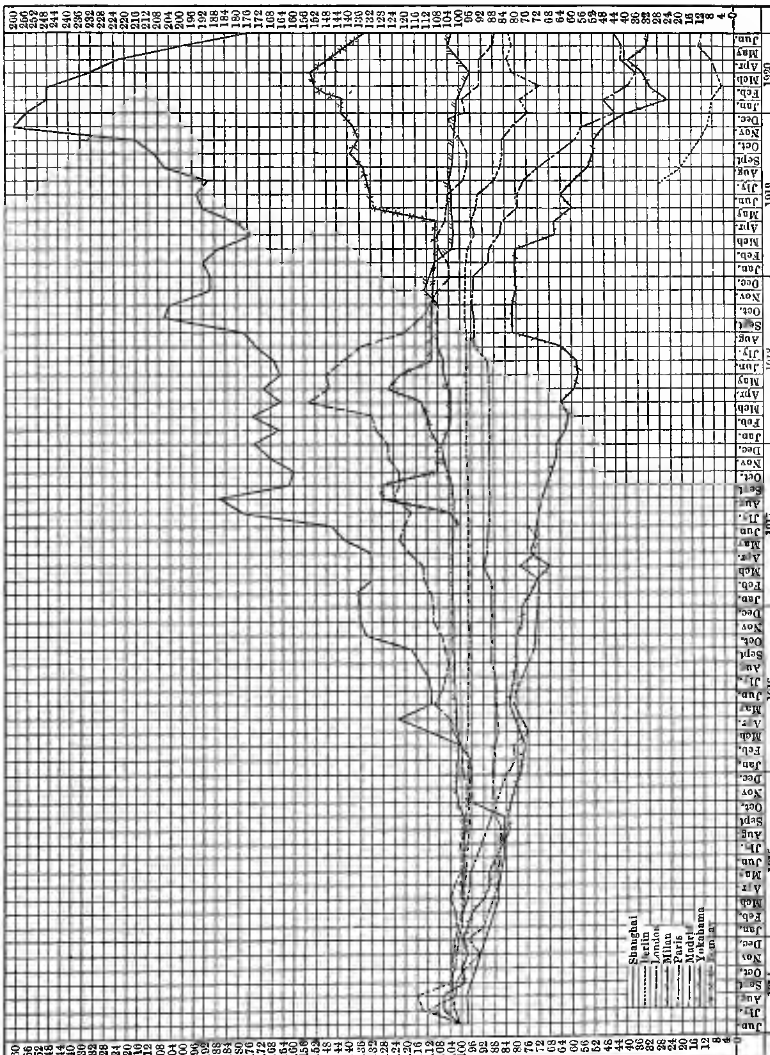

Figure 37. Chart Showing General Deviation of Rates from Mint Pars

most countries, and embargoes were laid on the exportation of gold by some countries and on its importation by others. The paper inflation that ensued is indicated by the following table:

TABLE SHOWING PAPER INFLATION DURING THE WAR

(In millions)

Date	Bank of England		Bank of France		Reichsbank	
	Gold	Notes in Circulation	Gold and Silver	Notes in Circulation	Gold and Silver	Notes in Circulation
1913, Dec.	$170	$144	$ 806	$1,111	$351	$ 630
1920, May	547	542*	1,133	7,380	266	11,953†

Date	Bank of Italy		Austro-Hungarian Bank		Bank of Japan	
	Gold and Silver	Notes in Circulation	Gold and Silver	Notes in Circulation	Gold and Silver	Notes in Circulation
1913, Dec.	$323	$ 444	$304	$ 505	$109	$207
1920, Apr.		2,441‡	(Mch.) 58	12,133	447	604

* Includes $1,700,000 currency notes.
† Does not include $2,795,000,000 Darlehnkassenscheine in circulation.
‡ Does not include $454,260,000 Treasury notes in circulation.

During the war Great Britain procured the whole of the output of the Rand mines at the standard price; but in the autumn of 1919 free dealings in the new output were permitted, provided it was all brought to the London market. Gold straightway commanded a premium in currency. This premium reached its highest point on February 5, 1920, when gold sold at 127s., 4d., or approximately 50 per cent premium, which was equivalent to a depreciation of the exchanges by about 33 per cent.

Under a régime of gold-paper or paper-paper exchanges, the rates vary with the relative degrees of inflation in the trading countries. The great force driving lira, mark, ruble, and other exchange rates to low levels was this factor of inflation.

Factors Influencing Demand and Supply of Exchange

Aside from this inflation factor, the exchanges have been much affected by the unusual balances of trade and other international payments and by the high price of silver. These facts can best be realized by a review of the influences affecting the demand for and supply of bills of exchange in New York in recent years.

The total demand for bills embraces the following:

1. Payments by Americans of importations of merchandise.
2. Payments of freight, insurance, bank commissions, etc., to foreigners by Americans.
3. Remittances by immigrants in America to their home lands.
4. Bills (and letters of credit) bought for travel by Americans abroad.
5. New loans by Americans to foreigners.
6. Repayment by Americans of the principal of old loans, and the repurchase of securities by them.
7. Payment by Americans of interest on old loans.
8. Speculative purchases of exchange by Americans—purchases with the expectation of sale later at higher prices.

The total supply of bills embraces the following

1. Receipt of payment for exported merchandise by Americans.
2. Payments of freight, insurance, bank commissions, etc., by foreigners to Americans.
3. Remittances by Americans sojourning abroad.
4. Bills (and letters of credit) used by foreigners traveling in America.

5. New loans by foreigners to Americans.
6. Repayment to Americans by foreigners of the principal of old loans, and the repurchase of securities from Americans.
7. Payments of interest to Americans by foreigners, on old loans.
8. Speculative sales of exchange by Americans—sales with the expectation of later repurchase at lower rates.

The Balance of Exports and Imports of Merchandise

The war has created a tremendous increase, both absolute and relative, in the export balance of the United States. The figures for the five fiscal years preceding the war and the five years during the war are as follows:

Date	Merchandise Exports	Export Balance
1910	$1,744 million	$ 188 million
1911	2,049	522
1912	2,204	551
1913	2,465	652
1914	2,364	470
1915	2,678	1,094
1916	4,333	2,135
1917	6,290	3,630
1918	5,919	2,974
1919	7,225	4,129

It will be noted that exports increased nearly threefold and the export balance nearly fourfold during the latter five years. The consequence was that, so far as merchandise shipments were the cause, the supply of bills, after the acute temporary disturbance accompanying the declaration of war in the summer of 1914, far exceeded the demand, and the rate of exchange fell below the gold import point. A tide of gold set our way. Our gold receipts in 1915 and 1916 were nearly a billion dollars and would have drained Europe but for the fact that gold export embargoes were laid by the various governments and that provisions were made, after the United States entered the war, for sustaining the exchange rates by borrowing in the United States. These specie and merchandise movements are indicated below in round figures, for calendar years:

TABLE SHOWING SPECIE AND MERCHANDISE MOVEMENTS TO AND FROM THE UNITED STATES DURING THE WAR

(In millions)

Excess of	1913	1914	1915	1916	1917	1918	1919	Total
Mdse. exports....	$691	$324	$1,776	$3,091	$3,281	$3,118	$4,019	$16,298
Silver exports.....	26	25	19	39	30	181	150	470
Total..........	$718	$349	$1,795	$3,129	$3,311	$3,299	$4,167	$16,768
Gold imports.....	....	....	420	530	180	20	......	1,150 } net
Gold exports.....	28	165	....	....	....	....	292	485 } 665
Grand Total....	$746	$515	$1,374	$2,599	$3,131	$3,279	$4,459	$15,633

So long as the export balance of merchandise continues, it will tend to keep exchange rates low.

Payments of Freight, Insurance, Bank Commissions, etc.

Before the war the United States was largely dependent upon foreign-owned shipping to carry her commerce. The result was that her annual payments to England, Holland, Norway, Denmark, and other maritime peoples, for freight, amounted to probably $100 million. This occasioned a demand for that amount of exchange. The war caused England and other European carriers to fall behind in their rate of building merchant bottoms and gave a tremendous impetus to shipbuilding in the United States. The submarine activities cost England and France thousands of tons of ships, and the wear and tear and want of repair during the war rendered many more vessels quite useless. The result is that our merchant marine is nearly equal to England's, and the balance of freight payments approaches zero and may turn in our favor. Thus a factor that formerly caused a net demand for bills of exchange may now cause a net supply—at least this element of net demand has quite expired.

Likewise, but to a less degree, payments for bank commissions have declined with the growth of dollar exchange and our discount market, New York having become a financial center nearly equaling London. Marine insurance companies also have secured a better footing in New York. The demand for bills formerly caused by these factors is therefore subsiding.

Remittances by Immigrants

Before the war thousands of immigrants came to the United States and found lucrative employment. Some of them stayed only for the summer months, returning to Europe for the winter. But whether or not they returned, they sent home large sums to their people by means of bills of exchange or post-office money orders, probably to the extent of $100 million a year. The war stopped immigration and to a considerable degree cut off remittances by those immigrants who did not answer the call to arms of their native land. Many immigrants also are yielding to the Americanization movement and will cease sending funds to Europe. On the other hand, the revival of immigration since the war will sustain this net demand for exchange. The earnings of Americans abroad have always been inconsiderable.

Travelers

In the past more Americans have traveled in Europe than Europeans in America. The result has been a net expenditure by Americans abroad, and a consequent net demand in New York for bills of exchange (or letters of credit) to transfer funds to Europe to cover the expense of travel. This item of exchange formerly bulked quite-large in our international payments and was heaviest in the summer months.

New Loans, Repayment of Old Loans, and Repurchase of Securities

From the beginning of the history of the United States its citizens have borrowed heavily from Europe. Not until 1873 did the annual volume of new loans to the United States amount to less than the sum of the payments of interest and of the principal of old loans. But our large excess of merchandise exports during the war made it possible for us to repay our debts abroad, to repurchase the American government, municipal, and corporate securities which Europeans held, and to lend additional amounts to the governments and peoples of Europe. The result is that we have passed from a debtor into a creditor nation.

The effect of the repurchases of our securities, of repayments of old loans, and of the granting of new loans, is to occasion a demand for an equal amount of exchange. This demand has been the chief sustaining force in keeping up the exchange rates in the face of a huge merchandise export balance. During the years 1915 and 1916 England and France were able to peg their exchange rates by floating loans in the United States and by despatching, at strategic times, large amounts of gold. After the United States entered the war, loans were employed by the American government, in conjunction with the British, French, and allied treasuries, to peg the exchange rates. The government of the United States borrowed from the people by issues of Liberty and Victory bonds and advanced funds to the amount of nearly $10 billion to the Allies. This financial policy enabled the British government to buy all the exchange offered in New York at a price approximating 4.76 and peg the rate at that level, thus reducing the cost of allied purchases in America. France and Italy pegged the franc and lira exchange rates in somewhat similar manner. The advances by the United States to the

Allies equaled approximately their merchandise purchases. In March of 1919, the allied governments gave up the effort to peg exchange, the Secretary of the Treasury thereafter made comparatively small advances, having exhausted his $10 billion loan fund, and exchange rates fell precipitately.

In normal times, when the gold import point was reached gold would have poured into the United States, but this was now made impossible by the gold export embargoes in force in England and France and other European countries. The American exporter, therefore, no longer had the alternative of importing gold, but had to sell his bill for what it would bring. It fell in price until some buyer with funds in New York was willing to purchase it and thereby loan to the debtors abroad; that is, the buyer of the bill substituted himself as creditor to the foreign importer. Obviously the only bottom to this slump of exchange rates was:

1. The necessity of the importer and the prices that he was willing to pay for American goods.
2. The willingness of the American exporter to sell the goods.
3. The amount of funds Americans were willing to lend to European importers.

Payments of Interest on Old Loans

During the past two centuries the people of England, France, and other European countries had invested billions of dollars in American stocks, bonds, mortgages, land titles, mine royalties, etc. The interest and profits and rents flowing to Europe annually from these investments constituted a large net item in the demand for bills of exchange in New York.

The war, by converting us from a debtor to a creditor nation, has reversed this net flow of funds and has therefore added to the supply of bills of exchange, whereas our former indebtedness to Europe added to the demand. Interest payments hereafter will tend to keep the rate of exchange low.

Speculative Purchases and Sales of Exchange

In the long run speculative operations in exchange do not affect the volume of supply and demand of bills of exchange; purchases of exchange contemplate a later sale, and sales contemplate a later purchase to cover. To the degree that buyers and sellers forecast the fluctuations in rates correctly, they tend to reduce those fluctuations and make the rate move more evenly from day to day; but to the degree that their forecast is wrong, and to the degree that they manipulate the exchanges by the tricks of the trade, they make the fluctuations more violent. Speculation is inevitable in any commodity the price of which is fluctuating, and honest effort to forecast the fluctuations is socially, economically, and morally justifiable, whether it be concerned with wheat, stocks, or bills of exchange. The unprecedented status of the foreign exchanges at present make speculation prevalent, difficult, and risky.

Effect of War on Far East Exchange

By singular coincidence, at the very time when the rates on most European countries were at unprecedented discounts, the rates on the Far East were at unprecedented premiums. Our balance of trade to these countries was adverse, and the demand for bills on these countries exceeded the supply. When the United States removed the embargo on gold exports, gold moved in large amounts to Japan. In order to liquidate the trade balance silver was exported to Shanghai, Hongkong, and India, countries on a silver basis or willing to accept silver in settlement of debts. This movement was facilitated by the Pittman Act of 1918.

Not only did the adverse balance of trade with these countries force exchange rates upward, but also the rising price of silver accelerated the rise. The following table shows that the price of silver in New York nearly trebled during the war. If an American importer owed for goods bought in Shanghai, he had to buy, with gold or other money, enough silver to settle the account or buy a bill for that amount; and since these were alternative methods the price of exchange rose with the price of silver. Under the influence of these two forces the cost of one tael rose from 65.49 cents in 1913 to 170 cents in 1919.

		Price of Silver New York City	Shanghai Exchange
1915	June	$0.510 per oz.	56.50 cents
	Dec.	.578	63.00
1916	June	.681	72.00
	Dec.	.798	89.00
1917	June	.857	90.38
	Dec.	.943	114.00
1918	June	1.071	113.50
	Dec.	1.062	125.00
1919	June	1.181	127.50
	Dec.	1.375	170.00
1920	Jan.	1.340	156.00

Effect of War on Canadian Exchange

The triangular nature of Canada's foreign trade is shown in the following table:

TABLE SHOWING CANADIAN FOREIGN TRADE DURING THE WAR*

(In millions)

Date	Total Trade †			Trade with United Kingdom			Trade with United States		
	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports	Balance
1913–1914	$ 455	$ 618	$—163	$222	$132	$ +90	$177	$396	$—219
1914–1915	461	455	+6	212	90	+122	186	297	—111
1915–1916	779	508	+271	463	77	+386	217	370	—153
1916–1917	1,179	846	+333	756	107	+649	291	665	—374
1917–1918	1,586	964	+622	861	81	+780	441	793	—352
1918–1919	1,268	920	+348	560	73	+487	478	750	—272
1919–1920	1,286	1,065	+221	496	126	+370	501	802	—301

* The figures of this table are taken from Babson's Statistical Service.
† Includes all countries.

Canada sells largely to Great Britain, and buys largely from the United States. Before the war, drafts sent by English importers were sent for sale to New York (Figure 38), where they usually commanded a premium large enough to offset the dis-

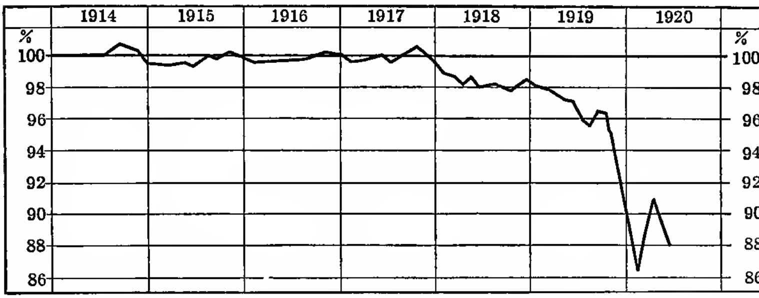

Figure 38. Graph Showing Canadian Exchange Rates at New York

count on Canadian exchange prevailing there. After the war the Canadians sold to the English on credit but kept paying cash to the United States. The result was that exchange in New York on Montreal went to a heavy discount, although Canada's balance of trade with the world was favorable. Canada has also been a debtor country, having borrowed heavily from capitalists in the United States and Europe. The payment of interest on this increasing debt also depresses Canadian exchange in New York.

CHAPTER LVI

THE TRADERS' DEPARTMENT

Functions of the Traders—Organization of the Department

The traders buy and sell exchange of all kinds for profit. They are the great money-makers of the foreign division of the bank. Whereas the other departments serve clients for commissions or fees—that is, make collections, handle securities, issue commercial and travelers' credits, accept bills drawn on the bank, make payments, transfer funds, etc., for commissions or fees—the traders earn for the bank the profits from buying exchange at one price and selling at a higher. They determine, in the light of market conditions, the asking and bidding prices of exchange and whether the bank should on a particular day enter upon a buying campaign or a selling campaign. The cable rate, check rate, and other rates are fixed by the traders and used by the other departments when it becomes necessary to debit and credit items payable abroad; for instance, the foreign discount department, which actually handles the paper bought and makes the accounting records, uses in its bookkeeping the rates fixed by the traders.

The responsibility of the traders is, therefore, very great, and the success or failure of the foreign division hangs upon their abilities. Only the most competent foreign exchange experts are appointed as traders. They must have a complete and expert knowledge of foreign exchange theory and practice and must be shrewd students of the market and tactful negotiators of sales and purchases. A quick comprehension of a situation, allied with the power of quick decision, is an essential qualification for success as traders. The general policy of a bank may be to curb speculative ventures, certain banks being more venturesome than others. Because of the high responsibility of the traders, they are usually made accountable directly to the bank officers in charge of the foreign division or are themselves officers.

The department organization is very simple. It consists of two or three traders, a clerk to handle and distribute the contract slips, and a telephone operator. The office is equipped with a ticker, general and private-wire telephones, and a counter over which brokers and traders converse.

Preparation of the Parity Sheets

Very little trading is done between 9 and 10 A.M., for at this time the traders are busily engaged in receiving daily quotations and discount rates by cable from Europe. Furthermore, the brokers come in at this time and the traders sound them to obtain as much information about the trend of the market as possible. From the cable quotations the traders prepare their parity sheets.

The parity sheet does not refer to mint parities but to commercial parities. A mint par, as has been explained in Chapter LIV, is the pure gold equivalent of the standard coins of two countries. The mint pars most commonly published in the financial page of the daily papers are as follows:

Canada	$1.00 per dollar
Germany	.2382 per mark, or .9528 per 4 marks
Italy	.1930 per lire, or 5.1826 lire per dollar
Belgium	.1930 per franc, or 5.1826 francs per dollar
France	.1930 per franc, or 5.1826 francs per dollar
England	4.8665 per pound sterling
Switzerland	.1930 per franc, or 5.1826 francs per dollar
Holland	.4020 per guilder or florin or gulden
Denmark	.2680 per crown or krone
Norway	.2680 per crown or krone
Sweden	.2680 per crown or krone
Spain	.1930 per peseta
Argentina	.9648 per gold peso
Japan	.4985 per yen

The commercial rates vary from the mint parities as the conditions of the market determine, and these rates follow the method of quoting the mint parity. There can be no mint parity between countries that are on different money standards; there may, however, be commercial parities between all countries.

The commercial parities are the relative values of foreign exchange on a certain day in United States dollars. To use normal pre-war rates for illustration, if the selling price of sterling demand exchange in New York City were 4.8765 and the buying price of sterling demand exchange in Hamburg were 20.47, the commercial parity for mark demand exchange in New York would be 95.29 (or $4.8765 \div 20.47 \times 4 \times 100$); but if the rates were 4.88 and 20.50 respectively, the commercial parity for mark demand exchange would be 95.22 (or $4.88 \div 20.50 \times 4 \times 100$). If the pound sterling were quoted in Amsterdam at 12.10 and in New York at 4.885, the guilder would be worth in New York 40.371 (or $4.885 \div 12.10 \times 100$). Or if the pound sterling were quoted at 25.22 francs in Paris and 4.88 in New York, one dollar is worth in New York 5.148 francs (or $25.22 \div 4.88 \times 100$). These parities mean that if the traders buy sterling in New York and send it to Hamburg, Amsterdam, or Paris, as the case may be, the cost of the currency produced by the sale of the sterling is 95.29, 40.371, or 5.148, respectively, and the exchange must be sold at higher prices than these to make a profit. The process is reversed if the continental exchanges are bought in New York.

These parities serve merely to guide the traders when buying and selling exchange. As the market changes constantly it is necessary to figure the parities daily, and should there be any changes in the price of sterling exchange, either up or down, the relative differences on continental exchanges would be added or deducted, as the case might be. For instance, the parity of mark demand exchange being 95.29 at 20.47 and 4.8765, should sterling rise in New York to 4.88, mark parity would rise to 95.36; on the other hand, should exchange in Hamburg fall to 20.46, parity for marks in New York would be 95.34. These changes would be figured mentally by the traders as they occurred.

Commercial parities are likewise calculated for long bills, and the interest factor must also be taken into account.

In making parity calculations the traders do not use tables. As changes take place in the market the traders sometimes alter the figures on the day's parity sheet and sometimes, just glancing at those already made, figure the changes mentally, using various short cuts in their calculations.

The bank receives daily, by cable, rates from the various countries with which it does an extensive business. These rates are usually firm offers or firm bids and are available, up to a certain amount, for acceptance by wire for buying and selling. The limits as to the amounts in each case differ, depending upon the size of the banking house that makes the quotations. The quotations received include the cable and check rate, on the various leading exchange points, and the discount rates. When the traders reach their desks in the morning the cable quotations from foreign cities are at hand and show just what changes have occurred in the markets overnight.

Using these cable quotations, the traders prepare their parity sheets, which are charts of the exchanges and the key to the foreign exchange situation. Figure 39 is a portion of such a parity sheet for a certain pre-war date.

Method of Using Parity Sheets

The first column is for the bank rate, that is, of the Bank of England, the Reichsbank, the Bank of France, etc. This figure enables the traders to keep track of the variations between the bank rate and the open market rate and to know how to calculate documentary payment bills. The changes in the London, Paris, and Berlin discount rates affect the exchange quotations. For example, if the discount rates and exchange rates close in a state of equality in London, Berlin, and Paris, and on the following

PARITY SHEET

Bank Rate	Discounts to Arrive	Sterling Exchange	Cable	Demand	D/A 30-day Sight	D/A 60-day Sight	D/A 90-day Sight	D/P 60-day Sight
3%	60 days 1 5/8%	*London*	486.50 buyers	486.20 buyers	486.20 1 3/4% 1.01	486.20 1 5/8% 1.61	486.20 1 3/4% 2.41	486.20 2% 1.92
	90 days 1 3/4%		486.55 sellers	486.25 sellers	485.19	484.59	483.79	484.28
4%	60 days 2 3/4%	*Berlin* 20.455 sellers 20.455 sellers	95.135 buyers	95.077 buyers	95.077 4% .370	95.077 2 3/4% .490	95.077 2 1/2% .650	95.077 4% .680
	90 days 2 1/2%	20.4425 buyers	95.203 sellers	95.144 sellers	94.707	94.577	94.427	94.397
3 1/2%	60 days 2 3/4%	*Paris* 25.19 3/8 sellers 25.18 7/8 sellers	517.75 buyers	518.17 buyers	518.17 2 3/4% 1.46	518.17 2.65	518.17 3.84	518.17 3 1/2% 3.30
	90 days 2 3/4%	25.18 5/8 buyers 25.18 1/8 buyers	517.54 sellers	517.97 sellers	519.63	520.82	522.01	521.47

Figure 39. Parity Sheet

morning the discount rate rises in London, exchange rates in Berlin and Paris will rise because of the demand in those cities for exchange on London. The cables to New York will indicate these increases and the exchange rate in New York will rise for the same reason. The rise in the London discount rate causes changes throughout the entire parity sheet, for cables, demand, and long bills.

When the market opens in the morning, the traders place in the cable column the selling and buying price for cables, and in the demand column the selling and buying price for checks. In buying an acceptance bill at 30 days' sight, the traders refer to a table prepared for the purpose and find that at the prevailing discount rate (stamp included) a deduction of 1.01 should be made from the demand rate, leaving in this case 485.19 (or 486.20 – 1.01) as the price to be paid for the 30 days' sight bill. This bill when delivered is sent to London for sale and credit and by the same mail is sent a draft drawn against it so that no interest will be lost while the bill is floating. The same process applies to the 60 and 90 days' acceptance bills sold to arrive at the price for these bankers' bills.

The 60 days' sight sterling payment bills are not discountable, as it is not known when they will be paid. They are commonly taken up before maturity, and interest is rebated in England at 1 per cent less than the bank rate and on the continent at the bank rate; but whether they are so taken up varies with the consignee, the conditions of the market, the nature of the goods covered, and the market rate for money.

The calculation of marks, francs, and the other exchanges is identical in principle.

The quotations published in the metropolitan dailies are not official in any way, as are the stock exchange quotations, but are gathered from the various banks and bankers, and if there is a brisk market and trading continues after the paper goes to press the quotations may change considerably from those published.

The rates appearing in the papers are, of course, derived from the parity sheets.

The Conference on the Exchanges

After the parity sheets have been prepared and before much trading occurs, it is the custom of banks to hold a conference upon the foreign exchange situation and to determine the day's policy as to buying and selling. This meeting is attended by the traders, the bank officers in charge of the foreign exchange work of the bank, and others whose counsel may be desirable. The preparations for this conference consist in making up the parity sheets, sounding the brokers for the drift of the market, and examining the position sheets, which describe the condition of the bank's balances, present and prospective, in the leading foreign exchange markets abroad.

At the meeting the condition of the foreign division at the close of business the night before is weighed. Special attention is paid to:

1. The total amount invested in foreign exchange, and all future contracts.
2. The exchange in balance, that is, the amount of foreign exchange on hand according to the books.
3. The foreign deposits, that is, the amount held by the bank on deposit for foreign correspondents.
4. The bank's rate of interest for demand loans.

The brokers report on the market situation; they know the tendency of the market the night before, the tendency as indicated by the morning cables from Europe, and the probable course of the bank's competitors as gleaned by conversations with the brokers. After a general discussion the policy of the day is determined. This policy, when adopted, is strictly followed unless instructions to the contrary are received from the officers of the bank. The policy may be to initiate an aggressive campaign of buying or selling, for the purpose of influencing the market, and then to recoup when the market reacts.

The Positions

For the use of the traders, different "positions" are kept by clerks attached to the traders' office.

1. The cable position is made up for the purpose of showing at a glance the bank's balances abroad which are available by cable. It shows exactly where its money is on deposit, and the different dates on which it becomes available for use. The position is made up by taking as a basis the balances on hand the day before; adding all payments and remittances for the bank's credit, by cable or otherwise; adding all future cables bought; deducting therefrom all payments to the bank's debit by cable, draft, or otherwise; deducting all future cables sold; and deducting the amounts required to meet commercial credit payments.

2. The sight position is made to show the position at the next outgoing mail, that is, is made to show in advance what the bank's balances would be upon the arrival abroad of the next outgoing steamer, if no sales or purchases took place while the steamer was on the ocean. The factors appearing in this position are the end cable balances at the close of business the night before, plus the depot bills and the bills purchased for the steamer under consideration, less the exchange sold for the same steamer. The calculation gives the demand or sight position.

3. The profit and loss position is to determine daily the profit or loss on exchange transactions, and the conditions of the stock of exchange and the average cost. The demand or check rate is used as the basis of the calculations. The prices of all time bills purchased are brought up to the check rate by taking into consideration the discount, costs, and stamps. The prices of

cables are brought down to the check rate by considering the element of interest. After all purchases and sales for the day have been entered on the sheets and each price correctly determined, they are totaled and the average price for the whole is calculated. As the purchases and sales for the day are never exactly equal, it is necessary to make adjustments. If sales exceed purchases and there is sufficient exchange in stock to cover the excess sales, the excess is taken from stock at the stock price; if purchases exceed sales, the reverse process is performed.

Actual Trading

After the conference on the exchange the trading begins for the day, and then quotations are sent all over the United States and Europe. Rates are quoted over the counter, over the telephone, by mail, and by telegraph. The bank may buy exchange not only in its home city but in every other market of the world, and it may deal in all kinds of exchange, with the possible exception, however, of its own long bills if it does not care for this form of borrowing to appear in its statement.

Some of the brokers have orders to buy and others to sell exchange; and as the brokers deal with the traders one at a time, it is the object of the traders to buy from one for account of his principal at one price and sell to another at a higher price. This object is accomplished in a variety of ways. For instance, if the market is due for an advance, the traders pay no attention to a broker who is a buyer and take only what the selling brokers offer; but the buying of the exchange at the price offered immediately leads the seller to raise his price, and thus the advance is already started on its way. If the sellers find their exchange is taken each time it is offered, the market continues to advance. On the other hand, the offering of exchange in a market which has no absorbing power will induce a fall in exchange rates.

Form of Exchange Contract

The contracts are very simple and are classified as follows:

	Bought	Sold
1. If the exchange is bought from or sold to another institution............	a	d
2. If the exchange is bought or sold through a broker............	b	e
3. If it is a straight arbitrage transaction	c	f

The form for each of these contracts is as follows:

(a)

Bought from........amount....rate......delivery..........
as per letter, telegram........number......New York, date
........by.........

(b)

Bought for the account of (this bank) of New York: from......
amount........rate........delivery........brokerage......
New York, date........broker.........

(c)

Bought from..........amount........delivery..........rate
........rate........rate........number........ New York,
date........broker.........

The forms (d), (e), and (f) are exactly like (a), (b), and (c) above, except that the words "Sold to" take the place of "Bought from." The contracts are filled out and signed by the trader handling the transaction and handed to the head of the cable desk in the foreign tellers' department.

Competition in foreign exchange business is very keen and is increasing as a greater number of banks open foreign departments, each new department bidding for business from concerns which have for some time bought and sold their exchange at some one bank. Price-cutting has developed, and close-buying mercantile houses are able to get their exchange at rock-bottom rates, as well as to speculate on future rates. The margins of profits to the foreign exchange banks per dollar of exchange handled have narrowed under the pressure of this competition.

Competition has also extended to the brokers. Their commission was formerly 1/16 per cent, but it gradually dropped until, before the war, it stood at about 1/128 per cent. While there is no fixed rate, at present brokers charge from 1/16 to 1/8 of a cent per pound sterling and 1 point on the continental exchanges, with the exception of marks for which they charge 1/4 to 1/2 a point. The tendency to decrease commissions continues.

Some years ago certain brokers began to speculate on their own account, buying from one bank in the morning and closing out in the afternoon and taking their profit or loss as the case might be. The practice spread until now there are very few brokers who do not speculate both between banks and among themselves. The probable effect of this competition among brokers and banks is to create a more sensitive market, more stable rates, narrower gradations, and approximately one rate in the whole New York market instead of several rates at the same time.

One very interesting and astute form of trading is known as "arbitrage," the buying and selling of exchange in one market to sell or buy it in another and profiting by the differences of rates in the markets.

Another interesting phase of the traders' work is the movement of gold from one country to another and the underlying principles which govern these movements.

English Money and Exchange Calculations

The limits of this book do not permit the calculations of all kinds of exchange problems and only a few of the more common ones are given. These, however, are typical. Since the method of quoting franc and mark exchange has been but recently changed, the problems will be stated with both quotations and solved accordingly.

1. The conversion of sterling, shillings, and pence to decimals of the pound, and vice versa.

In English money £1 = 20s. = 240d., and 1s. = 12d.

PROBLEM: Reduce £83 5s. 6d. to pounds.

£83 = £83.
5s. = .25 (5 ÷ 20) = .25
6d. = .025 (6 ÷ 240) = .025

∴ £83 5s. 6d. = £83.275

PROBLEM: Reduce £112.345 to pounds, shillings, and pence.

£0.345 = 20 × .345 = 6.9s.
0.9s. = 12 × .9 = 10 4/5 d.
∴ £112.345 = £112 6s. 10 4/5 d.

2. The conversion of sterling into dollars, and vice versa, at a given rate of exchange.

PROBLEM: Convert £250 into dollars at 4.84. (The problem may be stated: Find the cost of £250 at 4.84.)

250 × 4.84 = $1,210

PROBLEM: Convert £235 9s. 7d. into dollars at 4.86.

£235 9s. 7d. = £235.479
235.479 × 4.86 = $1,144.428

An easier way would be to multiply shillings by 24 cents and pence by 2 cents:

235 × 4.86 =	$1,142.10
9 × .24 =	2.16
7 × .02 =	.14
	$1,144.240

The slight difference in results is due to the fact that the shillings and pence are converted at 4.80 instead of 4.86.

PROBLEM: Convert \$3,750 into sterling at 4.88. (The problem may be stated: How many pounds sterling can be bought for \$3,750 at 4.88?)

$$3{,}750 \div 4.88 = £768.443$$
$$£.443 = 8.86\text{s.}$$
$$.86\text{s.} = 10.3\text{d.}$$
$$\therefore \$3{,}750 = £768\ 8\text{s.}\ 10.3\text{d.}$$

German Money and Exchange Calculations

In German money 1 mark = 100 pfennigs, and the decimal system applies.

1. The conversion of dollars into marks, and vice versa, at a given rate of exchange.

NEW METHOD OF QUOTATION

PROBLEM: Convert \$1,190.62 into marks at 2.15 cents per mark.

$$1{,}190.62 \div .0215 = 55{,}377.7 \text{ marks}$$

PROBLEM: Convert 5,000 marks into dollars at 2.15 cents per mark.

$$5{,}000 \times .0215 = \$107.50$$

OLD METHOD OF QUOTATION

PROBLEM: Convert \$1,190.62 into marks at 95 1/4.

$$1{,}190.62 \div .95\ 1/4 \times 4 = 5{,}000 \text{ marks}$$

PROBLEM: Convert 5,000 marks into dollars at 95 1/4.

$$5{,}000 \times .95\ 1/4 \div 4 = \$1{,}190.62$$

PROBLEM: Convert 5,000 marks into dollars at 95 1/4 plus 1/32.

$$5{,}000 \times .95\ 1/4 \div 4 = 1{,}190.62$$
$$1/32\% \text{ of } 1{,}190.62 = .37$$
$$5{,}000 \text{ marks} = 1{,}190.62 + .37 = \$1{,}190.99$$

PROBLEM: Convert 5,000 marks into dollars at 95 1/4 less 1/32.

$$5{,}000 \times .95\ 1/4 \div 4 = 1{,}190.62$$
$$1/32\% \text{ of } 1{,}190.62 = .37$$
$$5{,}000 \text{ marks} = 1{,}190.62 - .37 = \$1{,}190.25$$

PROBLEM: Convert \$1,190.99 into marks at 95 1/4 plus 1/32.

$$1{,}190.99 \div .95\ 1/4 \times 4 = 5{,}001.53$$
$$1/32\% \text{ of } 5{,}001.53 = 1.53^{*}$$
$$1{,}190.99 = 5{,}001.53 - 1.53 = 5{,}000 \text{ marks}$$

PROBLEM: Convert \$1,190.99 into marks at 95 1/4 − 1/32.

$$1{,}190.99 \div .95\ 1/4 \times 4 = 5{,}001.53$$
$$1/32\% \text{ of } 5{,}001.53 = 1.53^{*}$$
$$1{,}190.99 = 5{,}001.53 + 1.53 = 5{,}003.06 \text{ marks}$$

2. The conversion of a quotation for 4 marks into a quotation for 1 mark.

PROBLEM: 95 1/4 per 4 marks is equivalent to what rate for 1 mark?

$$95\ 1/4 \div 4 = 23.8125 \text{ cents}$$

PROBLEM: 95 1/4 plus 1/32 per 4 marks is equivalent to what rate per mark?

$$95\ 1/4 \div 4 = 23.8125$$
$$1/32\% \text{ of } 23.8125 = .00744$$
$$23.8125 + .00744 = 23.81994 \text{ cents}$$

French Money and Exchange Calculations

New Method of Quotation

The conversion of francs into dollars, and vice versa, when quotation is in cents per franc.

PROBLEM: Convert \$5,000 into francs at 20 cents.

$$5{,}000 \div .20 = 25{,}000 \text{ francs}$$

PROBLEM: Convert 25,000 francs into dollars at 20 cents.

$$25{,}000 \times .20 = \$5{,}000$$

Old Method of Quotation

1. The conversion of dollars into francs, and vice versa, at a given rate.

PROBLEM: Convert 5,000 francs into dollars at 5.16 1/4.

$$5{,}000 \div 5.1625 = \$968.52$$

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* Slight discrepancies will appear here since decimals were not carried out far.

PROBLEM: Convert 5,000 francs into dollars at 5.16 1/4 − 1/32.

$$5{,}000 \div 5.1625 = 968.52$$
$$1/32\% \text{ of } 968.52 = .30$$
$$5{,}000 \text{ francs} = 968.52 - .30 = \$968.22$$

PROBLEM: Convert 5,000 francs into dollars at 5.16 7/8 plus 1/32.

$$5{,}000 \div 5.16875 = 967.35$$
$$1/32\% \text{ of } 967.35 = .30$$
$$5{,}000 \text{ francs} = 967.35 + .30 = \$967.65$$

PROBLEM: Convert \$5,000 into francs at 5.16 1/4.

$$5{,}000 \times 5.16\ 1/4 = 25{,}812.50 \text{ francs}$$

PROBLEM: Convert \$5,000 into francs at 5.16 1/4 − 1/32.

$$5{,}000 \times 5.16\ 1/4 = 25{,}812.50$$
$$1/32\% \text{ of } 25{,}812.50 = 8.07$$
$$5{,}000 = 25{,}812.50 + 8.07 = 25{,}820.57 \text{ francs}$$

PROBLEM: Convert \$5,000 into francs at 5.16 1/4 plus 1/32.

$$5{,}000 \times 5.16\ 1/4 = 25{,}812.50$$
$$1/32\% \text{ of } 25{,}812.50 = 8.07$$
$$5{,}000 = 25{,}812.50 - 8.07 = 25{,}804.43 \text{ francs}$$

2. The conversion of a quotation in francs per dollar into a quotation of cents per franc.

PROBLEM: What is the value of a franc when quoted at 5.16 1/4?

$$\$1 = 100 \text{ cents}$$
$$1 \text{ franc} = 100 \div 5.1625 = 19.37046 \text{ cents}$$

PROBLEM: What is the value of a franc when quoted at 5.16 1/4 plus 1/32?

$$100 \div 5.16\ 1/4 = 19.37046$$
$$1/32\% \text{ of } 19.37046 = .00605$$
$$1 \text{ franc} = 19.37046 + .00605 = 19.37651 \text{ cents}$$

PROBLEM: What is the value of a franc when quoted at 5.16 1/4 less 1/32?

$$100 \div 5.16\ 1/4 = 19.37046$$
$$1/32\% \text{ of } 19.37046 = .00605$$
$$1 \text{ franc} = 19.37046 - .00605 = 19.36441 \text{ cents}$$

Calculation of Price of Documentary Long Bills

The above calculations do not show how the banker determines upon the rate he will pay for a bill; they assume a rate and effect a conversion at that rate. The factors considered in the calculation of the rate to bid for a bill embrace the drawee country, the drawee bank or merchant house, the usance, the discount rate, whether a documentary acceptance or payment bill is offered, whether it covers perishable or non-perishable goods, the commission to the foreign banker, the foreign stamp duty, if any, and the American stamp duty, the profit the banker wishes to make, and the check rate at which he can sell his demand draft. The variations of these factors are, of course, innumerable, and only two variations will be illustrated. In such calculations it was customary before the war to assume as a basis of calculation £1 = \$4.85 and to calculate interest at 365 days to the year and allow 3 days of grace on time bills. Greater accuracy may be achieved by using the existing sight rate rather than 4.85; in fact, this sight rate is now in general use and will probably continue in use until the exchanges again approach the mint pars.

1. Price that can be bid for a 60-day sight documentary acceptance bill on a prime London bank, if the buyer knows he can sell his demand draft on London at \$4.875 on the day he purchases the 60-day bill.

Assuming that no commissions are charged and that the London "to arrive" discount rate is 4% and that the bill can be sold on date of acceptance:

Discount deducted when bill is sold in London on day of acceptance................for 63 days at 4% on \$4.85...........	.033664
English stamp duty, 1/20% of 4.85........................	.002425
Margin of profit wanted by the American bank, 1/40%.......	.001215
Total charges to be deducted from demand rate	.037304

\$4.875 − \$.0373 = \$4.8377, which is the highest price the American can pay for the 60-day bill and make the profit he wishes. The bidder will probably bid 4.8375, which is the nearest standard rate. The difference between the sight rate and the buying rate is called the "spread." Any variation in discount, tax, or profit rates affects the spread.

The calculation of a 30-,45-, or 90-day bill would proceed in the same manner; interest would be calculated for 33, 48, or 93 days respectively and at the discount rates quoted for such usances; these rates are sufficiently higher to cover the greater risk.

The calculation would also be the same in case the bill were a prime commercial instead of a banker's bill; and also in case of commercial bills, not prime, except that the rates of discount and profit would be higher, to cover the greater risk.

2. Price that can be bid for a 60-day sight documentary payment bill on prime London bank, covering a shipment of perishable goods. This bill will presumably be taken up on day of acceptance and interest will be rebated at 1% less than the Bank of England rate.

Interest rebated on date of prepayment (the date of acceptance) at drawee's option, for 63 days at 3% on $4.85	$.025250
English stamp duty, 1/20% of 4.85	.002430
Margin of profit to American bank, 1/40% of 4.85	.001215
Total charges to be deducted from demand rate	$.028895

4.875 − .029 = $4.846, which is the highest price the American can pay for the 60-day bill and make the profit contemplated.

The calculation of the same bill, if drawn to cover a shipment of non-perishable goods, would proceed on the assumption that, since the goods are carried by slow steamers and are almost always warehoused upon arrival, the drafts will not be paid until maturity, but that, to be safe, the discount should be calculated at the retirement rate. Since banks do not have funds sufficient to carry many such payment bills, a method of handling these non-discountable bills is used whereby the bills are accepted as collateral by the London banker against the American bank's long bills drawn for discount in the New York or London market.

Many banks are opposed to offering their own long bills for sale; in such case, of course, this method cannot be used.

Arbitrage Calculations

As previously explained, arbitrage is the contemporaneous purchase of exchange in one market at one price and the sale in another at a higher price; or, at least, the transfer of funds indirectly from one market to another, whether or not price considerations are the chief factors. Formerly a wider margin of profit was made at arbitrage, but as the world is more closely knit together and as the number of arbitrageurs increase, the prices of exchange in the different markets more closely approximate one another. This tendency was disrupted temporarily by the war. The narrowing of profits because of the agreement of prices on the world's markets at any instant has fostered arbitrage transactions on the basis of the prices that are likely to prevail on markets tomorrow or a week hence; that is, it has introduced into arbitrage as between places a speculative time element.

The variations in arbitrage transactions are, of course, legion, and only a few illustrative calculations can be given here:

1. *Covering the Sale of a Cable on Switzerland.*

Suppose a cable has been sold by the bank on Switzerland, but the bank has no balances in Switzerland and must provide cover at once for this sale. This can be done with sterling, francs, or marks. The problem is to know which is cheapest.

Suppose the following rates exist:

In Zurich,	franc cables	can be bought for	100.135	francs
	mark cables	" " " "	122.96	"
	sterling cables	" " " "	25.2025	"
In New York,	franc cables	" " " "	5.15	"
	mark cables	" " " "	95.375	cents
	sterling cables	" " " "	4.887	dollars
	Swiss cables	" " sold "	5.157	francs

To cover through London:

£1 sterling in London = 25.2025 francs in Zurich
$4.887 in New York = £1 sterling in London
∴ $4.887 in New York = 25.2025 francs in Zurich
$1.00 in New York = 25.2025 ÷ 4.887 = 5.157 francs in Zurich;
that is, $1.00 in New York will cover 5.157 francs in Zurich.

To cover through Paris:

1 franc in Paris = 1.00135 francs in Zurich
$1.00 in New York = 5.15 francs in Paris
∴ $1.00 in New York = 5.15 × 1.00135 francs = 5.15695 francs in Zurich;
that is, $1.00 in New York will cover 5.15695 francs in Zurich.

To cover through Berlin:

4 marks in Berlin = $.95375 in New York
1 mark in Berlin = $.2384375 in New York
1.2296 francs in Zurich = 1 mark in Berlin
∴ $.2384375 in New York = 1.2296 francs in Zurich
$1.00 in New York will cover 5.1569 (or 1.2296 ÷ .2384375) francs.

If, then, $1 will buy:

5.15695 francs through Paris, or
5.1569 " " Berlin, or
5.157 " " London

the three exchanges are practically on a parity, and the bank could remit cover in francs, marks, or sterling at about the same cost. But if the bank could sell mark cable in Switzerland at, say, 1.23 instead of 1.2296, this exchange would work out more favorably than the other two (123 ÷ .2384375 = 5.1585 francs), and would afford a profit (5.1585 – 5.157).

If the rates of marks and francs in New York had been quoted in cents per mark and franc, respectively, the cost of covering would have been calculated as follows:

Rate of franc cables in New York, 19.4175 cents (that is, the equivalent of 5.15 francs per dollar).

Rate of mark cables in New York, 23.84375 cents (that is, the equivalent of .95375 per 4 marks).

To cover through Paris:

1 franc in Paris = 1.00135 francs in Zurich
1 franc in Paris = 19.4175 cents in New York
∴ 1.00135 francs in Zurich = 19.4175 cents in New York
1 franc in Zurich will cost 19.39132 (or 19.4175 ÷ 1.00135) cents in New York.

To cover through Berlin:

1 mark in Berlin = 1.2296 francs in Zurich
1 mark in Berlin = 23.84375 cents in New York
∴ 1.2296 francs in Zurich = 23.84375 cents in New York
1 franc in Zurich will cost 19.39143 (or 23.84375 ÷ 1.2296) cents in New York.

To cover through London:

1 pound in London = 25.2025 francs in Zurich
1 pound in London = $4.887 in New York
∴ 25.2025 francs in Zurich = $4.887 in New York
1 franc in Zurich will cost 19.39093 (or 4.887 ÷ 25.2025) cents in New York.

Obviously, it is cheaper by a trifling figure to cover through London.

2. *Converting Sterling into Francs.*

If the bank has too much sterling exchange on hand but its stock of franc exchange is low, and if sterling rates in Paris tend downward, the bank will be tempted to remit sterling to Paris.

If the price in New York for sterling cable is 4.887, and in Paris 25.17375,

1 pound sterling in London = $4.887 in New York
1 pound sterling in London = 25.17375 francs in Paris
∴ $4.887 in New York = 25.17375 francs in Paris
$1.00 in New York will, through sterling, buy 5.1511 (or 25.17375 ÷ 4.887) francs in Paris.

Hence, if the selling rate of francs in New York is 5.15, the profit would be 11 points.

3. *Selling Marks to Paris.*

If the bank sells demand exchange on Paris at 5.15 5/8 – 1/64, and covers through mark exchange at 95 3/6 – 1/64, it will be covering at 5.1648, with a profit of 78 points, if the Paris rate for marks is 122.925.

5.15 5/8 – 1/64 reduced to decimals is 5.157, and
95 3/16 – 1/64 " " " " 95.202.
4 marks in Berlin = $.95202 in New York
1 mark in Berlin = $.238005 in New York
1 mark in Berlin = 1.22925 francs in Paris
∴ $.238005 in New York = 1.22925 francs in Paris
$1.00 in New York will, through Berlin, cover 5.1648
(or 1.22925 — .238005) francs in Paris.

If the rates were quoted as 19.3911 cents per franc and 23.8005 cents per mark, the calculation would be as follows:

1 mark in Berlin = 23.8005 cents in New York
1 mark in Berlin = 1.22925 francs in Paris
∴ 1.22925 francs in Paris = 23.8005 cents in New York
1 franc in Paris will cost 19.3618 (or 23.8005 ÷ 1.22925) cents in New York.

The profit from the operation would be .0293 (or 19.3911 – 19.3618) cent per franc.

4. *Selling Sterling Long Bills to Berlin.*

At times the Berlin market bids keenly for prime sterling long bills for investment, especially when short term exchange is low in Berlin. The American bank sends such bills to London for acceptance and forwards them to the buyers in Berlin, who usually hold them till maturity.

If, for instance, Berlin were bidding for 90-day London bills 20.34 marks per pound sterling, and these bills could be bought in New York for 4.845,

1 pound sterling = 20.34 marks in Berlin
1 pound sterling = $4.845 in New York
∴ 20.34 marks in Berlin = $4.845 in New York
1 mark in Berlin could be bought for 23.82 (or 4.845 ÷ 20.34) cents

Against the credit thus established in Berlin, sight exchange may be sold.

5. *Two-Point Arbitrage.* The above operations are called "three-point" arbitrage because there are three geographical

points concerned. It is possible to have an arbitrage transaction between two points when the quotations as between them are not at parity in terms of one another.

If at a certain time the demand rate in New York on London were 4.85, the reciprocal rate in London on New York ought to be 49.4846 (or 240 ÷ 4.85) pence per dollar. If the London rate were 49.80, which is equivalent to a parity of 4.82 in New York, and were thus out-of-line with the New York price, two dealers acting in partnership or agency might arbitrage to advantage. The English bank would draw on the American bank for, say, $1,000 and sell the bill on the London market for 49,800d. The English bank would at the same time instruct the American bank to draw on it for a sterling amount which, when the bill is sold on the New York market, will yield $1,000 to cover the first bill. The latter bill would be for (1,000 ÷ 4.85) = £206 3s. 8.5d., or 49,484.5d. The English banker would, therefore, have received 49,800d. and have to meet a draft for 49,484.5d.; the difference between these amounts represents the profits from the operation.

The effect of these reciprocal sales would be to increase the supply of dollar exchange in London where the rate was high, and therefore to tend to lower that rate; and to increase the supply of sterling exchange in New York where the rate was high, as viewed by the London estimation, and thus tend to lower the sterling rate in New York. Lowering the New York rate on London and the London rate on New York tends to bring the rates into line.

If the London rate were 49.28d., which is the equivalent of a 4.87 parity in New York, it is obvious that the dollar would be undervalued in London and sterling would be undervalued in New York. Under such conditions the arbitrage operation would be for the dealers each to purchase exchange on the other market and remit to the other dealer. These reciprocal purchases would tend to bring the quotations into line.

Gold Shipments and the Calculations of Their Profits

Very intimately connected with the arbitrage and other trading operations are the importation and exportation of gold, the time and direction of which are determined upon by the traders. As explained in Chapter LIV, the gold export and import points depend primarily upon the expense of shipping specie. In the case of exportation of gold to London from New York, the elements of calculation of profit include the initial outlay for the gold coin or bullion, the incidental expenses for packing, cartage, freight, insurance, and interest, and the proceeds of the coin or bullion when sold to the Bank of England, and the prevailing price of exchange which is sold against the shipment. The following problems will illustrate the calculation of profits:

1. The exportation of $1,000,000 gold coin from New York to London, when sight exchange in New York is 4.8925.

$1,000,000 contains, according to coinage laws, 53,750 (or 1,000,000 × 25.8 × .9 ÷ 480) ounces pure gold, but the Bank of England buys by weight and the deduction for abrasion, etc., will be taken into account in the price offered. If it pays £3 16s. 4 1/4d. per ounce, the amount yielded will be £205,201.

The expenses of such shipment are, say:

Freight (at 5/32% of value)	$1,665
Insurance (at 1/20% of value)	500
Interest (at 4% for 3 days)	335
Cooperage, packing, and cartage	75
Commissions (none usually charged between correspondents)	0
Gratuities	10
Total	$2,580

Therefore, the total cost of procuring £205,201 credit abroad is $1,002,580 (or 1,000,000 + 2,580). This is equivalent to $4.8858 per pound sterling. If, by hypothesis, the bank can sell sight exchange at 4.8925 on day of gold shipment, its profits will be $0.0067 (or 4.8925 − 4.8858) per pound sterling. Under normal circumstances banks are unwilling to undertake the exportation of gold for less profit than $.0015 per pound, which is 1/32%. The above calculation assumes that the bank loses 3 days' interest; the loss ranges from 1 to 3 days in actual practice, depending upon the day and hour when the steamer sails and whether the sight exchange is paid in currency or by draft on a clearing house bank.

It will be observed that the profit will be increased by any of the following events:

1. That the interest period be less than 3 days.
2. That the gold coins be less abraded, and that the Bank of England pay a higher price.
3. That the freight, insurance, or interest rate, or the charges for cooperage, packing, or cartage, fall.
4. That gold bars be shipped instead of coins.
5. That sight exchange command a higher rate in the New York market.
6. That commissions be not charged.

2. The importation from London into New York of gold bars containing 72,560 ounces of standard gold, when the price of such bars in London is £3 17s. 10 1/2d., when the rate of interest in New York is 6%, and when cables on London in New York sell for 4.845.

The cost of the gold in London is £282,530.5 (or 72,560 × £3 17s. 10 1/2d.).

Incidental expenses:

Packing and carting, say	£ 12.0
Freight (at 5/32% of value)	441.5
Insurance (at 1/20% of value)	141.2
Total outlay in London	£283,125.2

Value of gold in New York:

(72,560 × 11/12 × 20.67183) =	$1,374,945.43
Less: charge for copper	145.43
	$1,374.800.00

Cables for £283,125.2 will bring 10 days later	$1,374,800
£1 will bring (1,374,800 ÷ 283,125.2)	$4.8557
Deduct interest for 10 days at 6% from $4.8557	.0081
	$4.8476

If, therefore, the banker in New York can buy cables for 4.845, he will make $.0026 per pound sterling.

It is obvious that the profits will be increased by any of the following events:

1. That the price of gold bar fall in London.
2. That the rate for freight, insurance, packing, cartage, or interest fall.
3. That the price of copper alloy fall in New York.
4. That the time that the gold is in transit be shortened.
5. That the sterling cable rate fall.

If the New Yorker buys checks for remittance to purchase gold abroad, the interest will be calculated for 20 days, that is, 10 days for the checks to get to London, and 10 days for the return of the gold. The actual time required for transit on the Atlantic is normally between 7 and 10 days.

Transactions under Joint Account

Transactions are operated under joint account only when more favorable conditions are agreed upon than obtain in either "our" or "their" accounts. The rate of interest charged both here and abroad on overdrafts greatly exceeds the rate paid on credit balances; but in joint accounts the debit and credit rates agreed upon are equal or nearly so. It is also agreed between the parties to the joint account that of the buying and selling rates of exchange the most favorable will be employed when charging foreign amounts to this account.

To illustrate, suppose the New York bank and London bank agree upon 3 per cent as the rate of interest on debit and credit balances in their joint account. On June 30, sterling demand bills for delivery July 1 can be bought at 4.8660, but so keen is the demand in the New York market for pounds sterling payable in London on July 1 that cable transfers can be sold for 4.8750. The traders buy from X in New York £10,000 demand, to be delivered July 1, and sell £10,000 cable to be paid to Y in London on same date. The London bank charges the joint account £10,000 value July 1 for the cable payment; and the New York bank credits joint account value same date at 4.8750, or $48,750 and charges joint account £10,000 demand at 4.8660, or $48,660 value July 1.

The steamer bearing this bill reaches England in time to have it collected on July 10 and the London bank credits joint account £10,000 value July 10. The cable charge, say 50 cents, is charged when the bill is rendered to the New York bank, say, July 31. There being no other transactions during the month, the New York bank credits joint account 23 cents interest on the credit balance of \$90 July 1 to July 31, that is, 30 days at 3 per cent.

The London bank notifies the New York bank that it has charged joint account £7 10s. interest at 3 per cent on the debit balance of £10,000 in joint account from July 1, when the cable payment was made, to July 10, when the London bank was reimbursed by the draft. The New York bank credits £7 10s. to joint account.

$$
\begin{array}{rl}
\$48{,}750 - \$48{,}660 = & \$90 \\
\$90 - \$.50 + \$.23 = & \$89.73 \\
£7 \text{ 10s. at } 4.866 = & \underline{\ \ 36.50} \\
2) & \underline{\$53.23} \\
 & \$26.62 \text{ (the profit to which each bank is entitled)}
\end{array}
$$

$\$26.62 = £5 \text{ 9s. 4d.}$

The London bank is instructed to charge the New York bank's account £5 9s. 4d., which it transfers to its own Profit and Loss account; and the New York bank charges \$26.62 to joint account, and credits Profit and Loss account. Now, had the London bank charged the New York bank 6 per cent interest on the debit balance, the interest would have been £15 and the account would have shown a loss. Likewise, the profit in joint account would have been practically wiped out if a profit in the rates of conversion had been taken by the operating bank.

The agreement to conduct a joint account may be a permanent understanding that either bank may use it when conditions warrant, or a special agreement may be undertaken on occasion to execute a particular transaction.

CHAPTER LVII

THE FOREIGN DISCOUNT DEPARTMENT

Functions and Organization of the Foreign Discount Department

The work of the foreign discount department is somewhat analogous to that of the discount department of the domestic division. It purchases or discounts foreign exchange items. These include documentary and clean bills of exchange, checks, and other written orders upon foreign countries for the payment of money. Items drawn in foreign currency are bought outright, but items drawn in dollars are merely discounted. The discount department of the domestic division discounts only dollar items having domestic drawees; the discounting of dollar drafts is, therefore, the particular function which is analogous in the two departments. The foreign discount department takes full charge of the item offered for purchase or discount and attends to all its requirements until the bank has been reimbursed for the funds advanced and the proper earnings have been credited to Discount account.

The work divides itself into four main lines:

1. Purchasing and discounting.
2. Remitting.
3. Settling.
4. Adjusting irregularities and misunderstandings.

These divisions may be operated separately or be combined in various ways; logically the first two combine, and the last two also combine to advantage. The clerks of the department include a window man, register clerk, checker, ticket clerk, check clerk, obligation bookkeeper, bookkeepers, claim clerk, open-item clerk, and correspondent clerk.

The rates of exchange at which the offerings drawn in foreign currency may be bought are determined by the traders, and so the foreign discount department is relieved of this phase of responsibility. But the determination of the rates on dollar drafts, the interest periods, the commission, exchange charges, stamp charges, and their calculation, are handled in this department. The department and section heads must, therefore, be versed in the practices of foreign trade, shipping, collections, and credit, and they must be expert in the details of the credit instruments used in international commerce. This is an earning department and its successful administration is essential to the income of the bank.

Examination of the Item at the Window

Most of the items received by the department are documentary bills of exchange covering exports from the United States, and are received from exporters, manufacturers, and forwarding agents. The other items are miscellaneous and include bankers' finance bills, merchants' bills drawn against earnings or credit balances carried with their foreign branches or agents, dividend warrants, warrants in payments of legacies or incomes, interest coupons, due bonds, foreign post-office orders, foreign army officers' warrants, etc.

Assume that the firm offering the item is of good standing, whose bills the bank discounts daily. The window man examines the letter of instructions accompanying the item to see that the item is accurately described therein. He then marks on the said letter the capital account against which the item is to be charged. Should the commodity covered by the exchange not be mentioned in the letter, he notes this information on it in general terms. If the letter does not state whether the discount charges are to be deducted from the face amount of the item or collected entirely from the drawee, this information is obtained from the draft itself and entered on the letter. The paying clerk follows these directions exactly. If no letter accompanies the item, the window man prepares a paper on which he notes the name of the firm offering the item, an accurate description of the item, and all the other facts just mentioned. The letter of instructions is then passed to the head of the department for review and directions.

Usually the set of documents accompanying an export bill is complete and consists of the bill of exchange, a full set of bills of lading, marine insurance certificate, consular invoice, merchandise invoice, certificates of origin, and health certificate. Oftentimes, however, the shipper will forward some or all of the documents direct to the customer, giving the bank a guaranty for their non-production, the purpose of this procedure being to make sure that at least one set of documents goes forward on the vessel carrying the merchandise, so that the consignee may be able to take immediate possession of his goods and avoid the possible payment of fines, storage charges, or premiums on withdrawal bonds.

The window man examines and checks the documents to see that all are complete, that there are no alterations unless duly initialed, that the insurance certificate amply covers the shipment and accurately describes it, and that all the documents are properly indorsed.

If the bank's charges are to be collected from the drawee, the window man computes them and adds them in red ink to the face of the bill beneath the numerals, in the form of "plus $2.18 our charges." If the amount of an item is not filled in for the reason that the manufacturer is shipping through a forwarding agent and desires the bank to include in the bill all the shipping and insurance charges, as reported by the forwarding agent, the window man adds these charges to the invoice value and completes the draft by filling in the proper amounts.

The window man then marks on an instruction blank the name of the correspondent to whom the item is to be sent and all special instructions which are to be put in the remittance letter.

The item and all documents are then passed to the clerk in charge of the bills register.

The Bills Register

The bills register is divided into sections, each section bearing a distinct set of numbers and devoted to a particular class of items. Special sections may be carried, say, for all items drawn:

1. On cities where the bank may have a foreign branch.
2. In sterling.
3. In francs.
4. In marks.
5. In currencies other than dollars.
6. In dollars, other than on cities specified above.

The register clerk determines the proper section for each item and stamps it with the next open number of that section. He indorses the bills to the order of the correspondent, unless the item is remitted to a branch of the bank, in which case indorsement is not necessary, for the branch can indorse on the parent bank's behalf. The items are then separated into originals and duplicates, and each set is securely fastened together. If the item is not drawn in duplicate and a duplicate could not be easily obtained, a photographic copy is made and kept on file. The following entries are then made in the bills register: the name of the immediate indorser, the amount of the draft, its tenor, the general nature and quantity of the merchandise, and the number which the indorser has given to the draft. The item is then passed to clerks who prepare the remittance letters.

The Remittance Letter

The remittance letter is written in English or the language of the addressee. It is prepared in quintuple—the original, duplicate, and copies for the bookkeepers and for retention in the department. The form provides for a complete description of the item, and such information as the bank desires for its own purposes is entered on detachable slips.

The bill and remittance letter are then checked, and the checker stamps special instructions on all the copies of the remittance letter. Some of these instructions have been indicated by the window man, and others are of a standing nature. A consideration of them will bring out the nature of the transactions.

The drawer is not called upon in every instance to pay the bank's discount charges. He may request the bank to give him the face amount of the bill and to reverse these charges, in which event the bank adds to the amount of the bill its charge and stamps the remittance letter:

> Kindly collect this draft, plus our charges of (the bank's commission), together with interest at (the prevailing rate) per cent from date of draft until approximate arrival of proceeds in New York. Stamps and all your charges are to be collected from the drawee.

As a general rule, the bank must use such instructions in its remittance letters as will get back to it the exact amount of money to which it is entitled, together with any advantage which market fluctuations may give it. On drafts drawn in foreign currency the rate of exchange is obtained from the traders, the seller is paid at that rate, and the item is forwarded to the correspondent with instructions that the bank's account with it, kept in the particular foreign currency, be credited with the proceeds.

Remittance Letter Covering Sterling Items

Pound sterling items drawn on the British colonies are handled in a distinctive way. The original bill, with the original documents, is despatched, say, to Australia, and the remittance letter is stamped:

Payable with exchange and English and Colonial stamps, at the current rate for negotiating bills in London on the Colonies.	Duplicate draft and documents have been forwarded to your London office for negotiation and payment of proceeds to the (correspondent of the New York bank) in London.

The duplicate draft and documents are accordingly forwarded to the London office of the Australian bank, with the following instructions:

Payable with exchange and English and Colonial stamps, at the current rate for negotiating bills in London on the Colonies.	Original draft and documents have been forwarded to your (city in colony) office. Please negotiate this draft and pay proceeds to the (correspondent of the New York bank) in London, plus your usual commission, for the credit of our account.

In this manner the American bank's account with the London office receives immediate credit for the face amount of its remittance. An Australian draft, irrespective of its tenor, is negotiated by the American bank at the demand rate on London. The bank is out of funds only for the time required for the voyage to London, and the drawee is obliged to meet all the charges calculated by the London banker.

Pound drafts drawn on Africa are made "payable with exchange as per indorsements, plus English and Colonial stamps." The remittance letter must be similarly stamped and also marked "for negotiation, payment of proceeds to the (correspondent of the New York bank) in London, plus your usual commission."

The statement of all time sterling drafts drawn "documents against payment" must bear a stamp reading:

> Documents can be surrendered
> to drawees against payment of draft
> under rebate of interest at 1/2%

> above the rate allowed by leading joint stock banks for deposits at 7 days' notice.

Time sterling drafts drawn "documents against acceptance" are sent to the London correspondents with instructions to hold them in their portfolio after acceptance, subject to further instructions. The further instructions are always issued by the traders, who determine when such items are to be discounted in the London market to advantage.

Remittance Letter Covering Dollar Items

Dollar items are handled in a different manner. If the dollar item is drawn with exchange on London or the British Colonies and the rate of exchange in New York on London is favorable, it may be converted into a pound draft at the prevailing rate and forwarded as a pound item, and the bank's sterling account is credited with the face amount of the draft. If the rate of exchange prevailing in New York on London were not favorable, the dollar item would be left in dollars and to it would be added the bank's commission charge and the interest charges for the period the bank expects to be out of funds; its remittance statement is stamped as follows:

> Please endeavor to collect this item at such a rate that you can instruct us to debit your account for the face amount together with charges as indicated on the schedule, upon receipt of advice of payment.

If, on the other hand, the discount charges have been met by the drawer, the bank merely asks for a rate which will enable the bank to debit the correspondent's account for the face amount only.

The remittance letter of dollar drafts drawn on other points and the drafts themselves are always stamped "payable by demand draft on New York" and this demand draft must be an approved banker's check. Should the correspondent bank not have an account with the sending bank, the statement is stamped:

> Please endeavor to collect this item at such a rate that you can remit us approved banker's check on New York for face amount.

If the drawer has instructed the bank to collect all charges from the drawee, the bank adds its commission charge and stamps the item:

> Kindly collect this draft, plus our charge of (the bank's commission), together with interest at (the prevailing rate) per cent from date of draft until approximate arrival of proceeds in New York. Stamps and all your charges are to be collected from the drawee.

Such items are difficult to handle for the reason that the correspondent may not accurately estimate the number of days until the proceeds arrive in New York, in which case the bank is out of funds longer than the period for which it gets interest from the drawee. It is then no longer possible to assess the interest charge upon the drawee, although the drawer's instructions were to collect all charges from the drawee. The question is: Can the drawer be morally bound for the interest for the few days due to misquotation of the bank's agent? When such a situation arises, all small charges are usually neglected and the larger claims are considered each on its own merits.

The remittance letter of all dollar items is stamped "payable by demand draft on New York." This clause gives the drawee the option of paying at rates calculated by the correspondent, or, if the drawee feels that he is being overcharged, of buying an approved demand draft on New York in the open market and tendering the draft in payment. If a correspondent attempts to enforce its rate to the exclusion of the demand draft, the drawee may refuse to pay the correspondent and remit direct to the drawer.

Items drawn on the Far East and the accompanying remittance letters are stamped with the so-called "Far Eastern" clause:

> Payable at the current rate of exchange for check on New York with interest at........per cent per annum from date hereof until approximate date of arrival of cover in New York, together with all collection charges and other expenses.

After all instructions are properly stamped, the original letter is attached to the original draft and documents, and the duplicate letter to the duplicate set. They are then given a final examination by the responsible member of the department, signed, and sent to the outgoing mail department for attention. Barring complications or errors the item is not heard from again until the acknowledgment, advice of acceptance, or advice of payment is received.

Passing on the Offerings

It was shown above that the window man, having examined the documents and checked them against the accompanying letter and having added certain data, passed the letter to the head of the department for review and directions. In accepting any items, it is understood that the window man does so subject to the decision of the department head as to whether or not they will be purchased (or discounted), and upon what terms. Some authority may be lodged with the window man with respect to items from familiar sources. Likewise the degree of authority conferred upon the head of the department by the bank officers varies with the bank. In all cases the offerings must ultimately be approved by the management. Discretionary power lodged with the department expedites business, for the items may be already in themails by the time the bank officers are able to act. Such delegation of responsibility is not without danger, however, and any item about which the department has any doubt whatever should be straightway referred to the officers.

In passing on an offering the most important thing to know is the credit of the drawer. He is primarily responsible. Legally he is bound to take up the draft if and when it is not duly paid by the drawee. If the purchase is made from an indorser, the drawer's account becomes secondary, for the bank can then seek reimbursement both from drawer and from indorser, or from either. The indorser's credit is therefore scrutinized as carefully as the drawer's.

The bank establishes lines, or limits of credit, for the various parties from whom it takes items. These limits are recorded in the obligors book. This book is so kept that it shows at a glance the approximate amount discounted and still pending for account of the various customers. The clerk in charge of this book, when offerings are referred to him, marks each letter with the amount of the line of credit, if any has been fixed, and the amount running for the account of the firm under consideration. The purpose of the book is merely to give an approximate idea as to the contingent liability of the drawer—approximate, because in the absence of a cable to the contrary, it is assumed that all items are paid upon the approximate maturity date calculated in the obligors books. If it be necessary to ascertain the exact contingent liability, it is determined by checking the items in the obligors books against the bills remitted ledgers of the foreign bookkeepers.

After noting the credit information on the letters, they are referred to the officers for approval. If the line of credit is exhausted, the offering must be declined or the line exceeded. If documents accompany the draft, covering non-perishable, staple, marketable merchandise, fully insured, the officers may decide to take the risk of exceeding the line. Other reasons may influence their decision, but normally items in excess of the line are turned down.

The Discount Rate

The offering having been approved, the department head marks next to each item the rate of discount. These rates are based on the following factors:

1. Interest for the length of time the bank may expect to be out of funds.
2. The bank's regular commission charge.
3. The correspondent's charges.
4. The bill stamps.

The bank adopts two general rates of interest, one for commercial houses and one for banks and bankers, say 6 per cent and 5 1/2 per cent respectively; these rates are, however, subject to change and exceptions. Commission charges are sometimes waived, usually when the bank remits to a branch or subsidiary. Bill stamps are required in most countries.

To illustrate how the discount rates are worked out concretely, assume a 90-day bill drawn on a place where all the above charges are made:

Interest for 90 days, plus 2 months required for two transits of the seas, at 6%	2 1/2%
Commission charge	1/8
Correspondent's charge	1/8
Bill stamp	1/4
The discount rate	3 %

In the case of some customers, and if it is difficult to estimate one or more of the elements considered in determining a definite rate, the bills are discounted upon a basis of "subject to adjustment." This phrase means that the bank advances to the customer at once 80 or 90 per cent of the face amount and credits the balance to Funds Retained account. Upon receipt of the advice of payment, the exact charges are deducted from the Funds Retained account and the balance is returned to the customer. Another way of handling the transaction is to advance the face amount of the discounted bill and upon receipt of the advice of payment send the customer a debit memorandum for the exact charges.

The rates on all items drawn in foreign currency are secured from the traders.

After the rates applicable to the purchases have been noted upon the letters, they are passed on to the payment clerk.

Method of Payment for Items Purchased

The clerk in charge of payments makes a duplicate record of the transaction as follows (using a typical transaction):

Date, March 3, 1921

BOUGHT OF: The American Exporting Co.,
104 Broad Street, New York City.

Your letter of March 2, 1921:

Amount	Description	Rate	Proceeds
$2,000.00	90 days Buenos Aires	2 5/8 $52.50	$1,947.50

Check herewith, or
Your account has credit.

The duplicate record is used as a charge ticket for the account against which the item must stand until some advice is received concerning it from the correspondent. The item illustrated, for instance, would be charged to Bills Discounted, Bills Remitted

Foreign, Buenos Aires, $2,000, the bill being charged at its face amount rather than at the amount of the proceeds.

If the customer does not have an account with the domestic division of the bank, the payment clerk prepares two credit tickets, the one crediting Cashier's Check account with the proceeds and the other crediting Discount account with the discount. When the item is drawn in foreign currency and the bank's profit is reflected in the rate of exchange, or when the face amount of the item is advanced to the customer and a debit memorandum is put through later for the charges, only one credit ticket need be used crediting the proceeds to the customer.

The memorandum of purchase and the debit and credit tickets are then attached to the letter and passed to the clerk who prepares the cashier's check. The check is signed and the charge ticket approved by a bank officer. The check and original purchase memorandum are sent to the customer, and the tickets to the general bookkeeper's department.

Settlements and Adjustments

The settlement and adjustment of items necessarily give rise to diverse operations, but the procedure may be described by presenting a typical case. Suppose a manufacturer at Troy sells a bill of goods to a concern at Rio Janeiro for $945.32, draws a bill for that amount and sells it to his Troy bank. The Troy bank resells it to its New York correspondent, say, on November 1. The bill is drawn at 90 days' sight. The New York bank counts on 60 days to send the item to the drawee and for payment to be received. The bank, therefore, discounts it for 90 days plus 60 days, the time it will be without funds. The bill will probably fall due about March 1. If the bank underestimates the period, it may ask the Troy bank for a check to cover the additional interest. Having bought the bill, the New York bank sends it to its Rio correspondent for acceptance and collection when due.

Now suppose the drawee disputes the bill, refuses to accept it, and insists that deductions amounting, say, to 20 per cent be made. The Rio bank reports the reasons for non-acceptance; the drawer offers to compromise by allowing, say, 10 per cent deduction. The Troy bank on, say, December 17, transmits these instructions through the New York bank to the Rio bank, and the New York bank through the Troy bank then instructs the drawer that it has followed his instructions. The cable to the Rio bank is now confirmed by letter and the case is more fully explained. A bill is prepared and sent to the drawer for the cable charges to Rio. Debit and credit tickets are also put through.

The New York bank may not hear from the item again until, say, May 15, when an advice of payment dated March 10 is received from Rio. The item has apparently been collected on March 10; but May 15 is the date upon which presumably the proceeds arrive at the New York bank and is taken as the value date when a debit ticket is put through charging the Dollar account of the Rio correspondent for the proceeds. Upon examining the advice of payment, it is noted that the Rio correspondent bank has deducted 10 per cent from the face of the draft "as per cable of December 17." The foreign bank also has deducted its charges of 1/8 per cent of the face amount, and a further charge of 50 cents to cover bill stamp, postage, etc.:

945.32 — (10 per cent of 945.32, or 94.53)—(1/8 per cent of 945.32, or 1.18)— .50 = \$849.11.

This amount is the net proceeds which the Rio correspondent advises the New York bank to debit to its account.

The cage bookkeeper in charge of the ledger wherein remittances to Rio are posted prepares the tickets to close out the entire transaction. He enters on the tickets the arrival date of the advice of payment, and the tickets are sent to the general bookkeeper's department.

If the mails are heavy and the bookkeeper very busy, he sends a notice to the drawer that his draft has been duly paid "subject to final adjustment where the same is required." The purpose of this notice is to inform the drawer at the earliest possible moment whether or not his drafts are being duly honored, so that if he has a second shipment ready for this Rio customer he may despatch it at once. If his drafts are not honored promptly and without dispute and deductions, he may want to cut off this customer. But the notice also gives the bookkeeper time to determine whether the bank has been out of funds longer than was calculated and whether further interest should be asked. When all such notices have been despatched and the bookkeeper finds time, he carefully examines the advice of payment to determine whether the Rio bank's charges are according to the rates agreed upon by the banks and whether there is any cause for claiming additional interest or charges or perhaps allowing him a rebate for some reason or other.

A subdivision of Bills Discounted Foreign is that of the items "subject to adjustment." This term includes all bills the time of which in transit during the collection process or for the collection of which the foreign correspondent's charges are uncertain. The whole or a percentage of the face amount of such items is advanced with the understanding that the determination of the exact amount of interest and charges is reserved until the advice of payment has been actually received but that these charges are to be borne by the drawer. In adjusting such an item the charges are based on the regular commission charge on the face amount of the draft, interest at the prevailing rate upon the amount actually advanced, and the exact charges and commissions of the foreign correspondents. The difference between the combined exchange and interest charges and the funds originally retained is credited to the drawer.

If no funds have been retained and the entire face amount has been advanced, the bookkeeper charges the correspondent's dollar account with the net proceeds as received from the correspondent and charges the account of the drawer with the amount of exchange, collection, and interest charges, if the drawer carries an account with the bank. Otherwise a cash credit ticket is prepared in anticipation of a check in payment of all such charges. The offsetting credits to these tickets are to Bills Discounted Foreign, Subject to Adjustment, with the face amount of the draft, and to Discount account with the amount of the exchange, collection, and interest charges.

If the foreign correspondent does not maintain an account with the New York bank, nor the New York bank with it, when a collection is sent abroad remittance must be received by demand draft on New York. The cage bookkeeper, upon receipt of the check, debits it to Collection account but delays putting through the tickets until sufficient time has elapsed for the collection of the draft to be effected. The tickets are the same as above except that they debit Collection account instead of the correspondent's dollar account with the bank.

Changing Discounts into Collections

In order to relieve itself of responsibility, the bank's policy may well be not to carry in the discount department items the payment of which will be unnecessarily delayed because of controversies between the drawer and drawee over the terms of the sales' contract. The department's policy should be to clear up every transaction within six months of the time of its purchase, and if that does not seem possible or probable, the time should be charged back to the drawer and the item entered for collection. The drawer should be asked to reimburse the bank for any advances received by him on the item, but this policy should be varied according to the credit of the drawer. Extensions of time change the terms of the original negotiation and must be approved by the bank officers. If the credit of the drawer is not of the best and does not warrant an extension of time, the department should request a check from him for the amount advanced, less any unearned interest. The commission rate, the correspondent's charges, and the cost of the bill stamps are not affected by putting the discount on a collection basis, for identical charges prevail in the foreign collection department.

CHAPTER LVIII

THE FOREIGN TELLERS' DEPARTMENT

General Functions and Organization

The more important duties of the foreign tellers' department are as follows:

1. To receive deposits for foreign account.
2. To receive payments to cover "sold" contracts.
3. To sell drafts on the bank's foreign correspondents.
4. To sell cable transfers.
5. To make letter payments in foreign countries for domestic clients.
6. To make payments in this country for foreign clients, by book transfer, check, or telegram.
7. To make payments to cover "bought" contracts.
8. To cash checks drawn on the bank by foreign depositors.
9. To buy and sell foreign specie.

It will be noted that in performing the first four duties funds are flowing into the bank, and in performing the last five duties funds are flowing from the bank. This distinction becomes the logical line of division as the department grows in size and may ultimately separate it into a receiving and a paying department. Accessory to these main lines are clerks whose duty it is to make investigations and to handle the incoming mail of the department.

Distribution of the Incoming Mail and Cables

The main duty of the mail clerk is to receive all incoming mail and cables and distribute them according to the transactions involved. The cables are received from the cable department; the mail clerk signs for and numbers them, and the foreign tellers are responsible for the execution of the business pertaining thereto. The mail clerk makes it his business to follow up each cable received and see that it is receiving proper attention. He follows up in the same way the mail received. After the transactions called for by the cables and letters received during the day have been effected by the various departments concerned, the original instructions sometimes revert to the mail clerk, who carefully examines them to see that they have been properly executed. He initials those he approves and sends them to the files, but those in error may be referred to the department head or to the department in which the mistake has originated. This scrutiny of the mail clerk, being the last check on a given transaction, carries weight and heavy responsibility.

The Foreign Receiving Teller

The foreign receiving teller receives and acknowledges all deposits made for the credit of foreign accounts. His work is analogous to that of the receiving teller of the domestic division, but it is more complicated with irregularities and varieties of items.

To protect itself, the rules of the bank may provide that only certain kinds of items are to be accepted by the teller. The rule may be, for example, that the acceptable items must be cash items; that no out-of-town check or voucher check be accepted, except in special instances; that checks must be drawn to the order of the bank or bear an indorsement well known to it; that all checks over $500 must be certified; etc.

In case an individual desires to make a deposit, he is requested to note all information pertinent thereto on a form which reads:

Enclosed please find check of..........................
for....................which please place to the credit of
................to be paid to (or for the use of).............
by order of................
Signed. ....
Advised by mail (or telegraph). Charges paid (or collect).

This form serves as the original instructions in connection with the deposit. In case the deposit is made by a bank, its memorandum serves as the original instructions, for usually such memorandum is full and complete.

When a deposit is made, the teller makes out a credit ticket. If the ticket covers a deposit of money, it is stamped "Debit cash" and turned over to the clerk running the journal. The receiving teller does not hold cash any length of time and never over night. At intervals during the day he turns over his receipts to the paying teller of the domestic division against the latter's receipt. The journal clerk proves his total at the end of the day against the amount deposited with the first teller.

If the credit ticket is made out for the deposit of a check against the bank, the teller issues a "hold" against the account drawn on and sends the check, with the original instructions, to the bookkeeper to initial if the instrument is good. If the check is drawn against another local bank and must be certified, the credit ticket is put on a spindle and the check is sent by messenger for certification. When it is returned certified, the check and respective ticket are sent together to the journal clerk. If the check does not have to be certified, it and its credit ticket are forwarded immediately to the journal clerk.

When the receiving teller is asked to credit a foreign bank's account and charge the account of a domestic correspondent bank, he puts through a double ticket, and from the letter of instructions are prepared a credit note and letter of advice, the carbon copy of which forms the permanent record of the bank. The receiving teller checks the credit note against the original instructions and sends it to the auditing department, which checks it against the entries on the account, initials it if it is correct, has an officer sign it, and returns it to the receiving teller. The letter, with enclosure, is then despatched through the foreign mail department.

A set of special cards containing instructions which must be followed in executing certain transactions is kept by the receiving teller, and these instructions must be referred to and adhered to. In accordance with their tenor, it may be necessary for him to issue special receipts or special advices or to cable advice of deposit to the foreign bank whose account is credited.

The receiving teller has at his disposal a tickler which shows the payments that are due each day for cable transfers, and he advises the cable transfer clerk of any payments not received that day. When he receives cash or checks to cover cable transfers, he prepares a credit ticket and also makes a record of this credit to Unpaid Exchanges. A special record is also kept of overdrafts, and in case any credits are received for any of the overdrawn accounts he at once advises the bookkeepers.

The Sale of Drafts on Foreign Banks

The bank stands ready to sell to customers its own drafts drawn on banks in all parts of the world. A customer wanting a draft applies for it by letter or on a special form which serves as the original instructions covering the transaction. This form has spaces for the entry of such data as date, drawee city, rate, number, to whose order, currency, and applicant's name and address. Ordinarily a request for a draft must be accompanied by check drawn to the order of the bank or with instructions to debit the applicant's account. Out-of-town checks received for this purpose are collected before the draft is issued. When the instructions are to debit an account, they must be written, not oral, and the signatures verified, after which a hold is placed against the account. If the account is not debited, the amount is charged to Unpaid Exchange and the checks received are credited to Unpaid Exchange.

To protect the bank, drafts are not issued before payment except to firms of the highest credit, and when a draft is sent by mail before payment a statement is enclosed for the amount due When drafts are issued against a debit to the account of the client, he is informed that "in accordance with the instructions contained in your" letter the bank has "placed the following amounts to your debit in account." When drafts are sold by contract to a bank, unless otherwise stipulated in the contract, payment is made on steamer day only; and the drafts are drawn and delivered on the day before steamer day and are paid for next day.

The requests for foreign drafts are passed upon by the draft clerk and he determines how the request shall be handled, that is, upon whom he shall draw, etc. He consults his standing instructions to find the proper drawee bank, and if no standing instructions cover the transaction he consults the men who prepare the position sheets, taking care that no draft is drawn which will knowingly overdraw the bank's account with a correspondent abroad. He then refers the request to the traders, who give him a rate. The tickets and the acknowledgment or bill are then prepared, and the draft is written on the particular form that applies to each country. The draft, original instructions, and tickets are carefully checked. A stub from the draft is sent to the auditing department to check against the book entry. The duplicate drafts and the stubs are filed with that department also.

It is important to despatch the advices of drafts on the first mail steamer in order to guard against having payment of a draft refused for want of advice. The letter of advice advises "having issued the following drafts" and lists those drawn since the last mail on that bank. When the draft is sent directly to the payee, an accompanying letter explains that "by the order of......... and for account of .... we beg to hand you enclosed" described draft and asks acknowledgment, and the remitter upon whose request the draft was issued is also informed by letter.

When bills are issued drawn at 60 or 90 days' sight, credit is made to Bills Payable account Long Bills Foreign Exchange, and a record of the drafts is kept in a long bills register. When the draft is accepted, the due date is noted in the register and at the proper time Bills Payable is debited and "our" account credited.

Some payments which the bank is requested to make abroad are handled by letter payments. In this letter the foreign correspondent is requested to make a given payment and charge the bank's account. A debit and credit ticket is put through much like the tickets and stubs in connection with drafts.

The Sale of Foreign Drafts by Interior Correspondents

By special arrangement it is made possible for certain of the New York bank's correspondents in the interior of the country to draw directly upon certain designated banks among the New York bank's foreign correspondents for its account. The New York bank furnishes the interior banks with a list of its foreign correspondents upon which they may draw their own drafts on London, Paris, or other points, in specified currencies, and bring into the transaction their account with the New York bank and the New York bank's account with its correspondent abroad.

To handle this kind of transaction special forms are used and the interior banks are advised as to the rates of exchange they are to charge. These rates are always above the existing market rate so as to protect the New York bank against any slight fluctuation from day to day. The quoted rates are changed from time to time with broad changes in the market. If the interior bank wishes to make a profit on the transaction, it charges a higher rate of exchange if the bill is drawn in foreign currency, and a flat charge if drawn in dollars.

The interior bank writes its own draft on the foreign correspondent and advises the New York bank of the transaction, enclosing with the advice either a check to cover or instructions to charge its account. The advice to New York is by telegraph if the drawing is for important amounts and there is any possibility that the draft will be presented for payment before the bank can confirm to the drawee. The New York bank then advises its foreign correspondent to honor the draft when presented and charge to its account. The foreign branches of the New York bank, if it has any, also use the same device, drawing drafts on all parts of the world and letting the drawee banks reimburse themselves by charging the New York bank's account kept with them.

Cable Transfers

A cable transfer is the transfer of funds abroad by cable. It is analogous to telegraphic transfers in domestic business.

Requests for cable transfers must give the complete name of the applicant and of the beneficiary. The cable transfer clerk decides how the transaction shall be executed; he determines upon the drawee either from standing instructions or from inquiry made of the men in charge of the position sheets. The traders give the rate of exchange. All this information is noted upon the request, and from it is prepared in triplicate a statement showing the amount to be paid, the rate, the dollar equivalent, the payee, the drawee bank, and the amount of cable charges. Cable charges for drafts of large amount may be waived. The statement is stamped "Received payment" or it serves as a bill, as the case may be, and is sent or handed to the applicant as an acknowledgment of the request. The duplicate remains in the department as a permanent record. The triplicate is filed with the auditing department.

The transfer clerk also makes out tickets covering the transaction, either crediting the drawee's account and charging the account of the applicant, or charging Unpaid Exchange, which will be credited later when payment by cash or check covering the cost of the transfer is received. Payment should be received before the cable is actually sent; only exceptional banks should be privileged to pay for the transfer the day the payment is effected abroad.

The clerk words the message as he thinks it should be cabled.

This message, together with the request, is turned over to the cable department, which, from these instructions, codes the message ordering payment. In this message a bank officer inserts the test words. If the cable transfer clerk, the cable department, and the bank officer each keep a record of these transfers, a very definite check is provided on the work.

The Foreign Paying Teller

All cables and the letters pertaining to payments and book transfers are delivered by the mail clerk to the foreign paying teller. He sorts them on the basis of their importance and cares first for those demanding expedition.

Payments may be made by mere book transfer, by the issuance of a cashier's check, or by telegraphic transfer. It is the duty of the foreign paying teller to determine how a given transaction shall be handled. He must determine whether payment should be made by check, cable, or book entries, and whether he should wire advice of a debit or credit or simply telephone the payee's New York office, and, if payment is to be made by wire, through what bank it should be handled, or, if by check, whether the check should be sent direct or through another bank, or be held awaiting call of the payee. To decide these and other problems the paying teller must surround himself with all available sources of information—telephone service, up-to-date lists of all the bank's depositors, both foreign and domestic, and the most recent bankers' directory, postal guide, city directory, telephone directory, etc., and the cards of special instructions which must be followed in executing certain transactions.

To assist the paying teller some investigators are necessary, as the carrying out of the transactions necessitates a great variety of special investigations. For instance, it may be necessary to check an item on an account to make sure that it has not already been paid, or to determine whether certain funds have been received before a requested payment may be made, etc.

If payments are being made against orders received by cable, the message must bear a test word or be initialed by an officer, and if made against orders received by letter the signatures must be verified. In either event, a hold for the amount is placed against the account to be debited and the original instructions are sent to the bookkeepers to ascertain whether the balance is sufficient. If the balance is insufficient, the bookkeeper states the exact condition of the account. The paying teller then searches the bank for credits to the account, and in case sufficient funds are not found, the question of allowing the overdraft is referred to the bank officers.

The Foreign Paying Tickets

After the signatures are verified and the holds are initialed on the original instructions, these instructions are handed by the paying teller to clerks who make out the necessary tickets. The form of these tickets varies somewhat, depending on:

1. Whether the transaction is a book transfer of funds from the bank's account with one foreign correspondent to its account with another correspondent.
2. Whether it is a book transfer of funds from one correspondent's account with the bank to another correspondent's account.
3. Whether a cashier's check is needed.
4. Whether a client's account in the domestic division is credited.
5. Whether there is one charge ticket but several credit tickets, or vice versa.
6. Whether telegraphic payment is made.

For making payments outside the home city the bank usually imposes a commission charge, a minimum charge of 25 cents, say, for amounts up to $2,000 and one-eighth per mille on larger sums. The clerk making out the tickets notes the amount of commission on the original instructions.

The following disposition is made of the tickets and original instructions:

1. If it is merely a book transfer, debit and credit advices are prepared from the original instructions, and the tickets are signed by an officer.

2. If a cashier's check is to be issued, the tickets and original instructions go to the clerk who prepares the cashier's checks.

3. If a domestic account is credited, the original instructions and tickets and credit advice are referred to an officer for approval; the tickets then go to the bookkeepers, the credit advice to the depositor, and the original instructions to the clerk who prepares a debit advice.

4. If the payment is by telegraphic transfer, the tickets, the transfer-of-funds letter in triplicate, and the telegraphic forms are referred to an officer for approval. The tickets are then sent to the bookkeepers, and the letter and the original instructions for the transfer go to the note teller who keeps the original of the letter and returns the other documents. The note teller is next informed of the amount of the telegraphic charges. Tickets charging the telegraphic charges to the bank that applied for the telegraphic transfer are then prepared, as well as the debit advice.

Payments by Cashier's Check

Cashier's checks are prepared in conformity with instructions. A convenient method is to fill two stubs for each check: one, showing number, amount, and payee, is left in the stub book; the other, showing also the amount charged, is left attached to the check until it is initialed by the signing officer, who sends it to the auditing department. The auditors check the stub against the book entry and file it. The clerk who draws the check also makes out duplicate receipts. The original instructions, tickets, receipts, and check are sent to an officer who initials the debit tickets, signs the check, and stamps the original instructions to the effect that the check has been issued by him on a certain day. The tickets are sent to the bookkeepers. From the original instructions debit advices are prepared.

The check and receipts remain together and are handled in one of four ways:

1. In case the payment is to a responsible party nearby, the check is delivered by messenger and the receipt, signed by the payee, is returned to the department.

2. If the payment is to a responsible party at a distance, the check and receipts are sent direct to the payee.

3. If the payment is to someone at a distance who is not known to the bank, the check and receipts are sent to a neighbor bank, which makes the payment to the payee and returns the signed receipts to the department.

4. If the payment is to some individual nearby who is not known to the bank, he is advised that the bank is instructed to pay him a sum of money and will do so upon proper identification; the check is held in a folder until delivered to the payee.

A careful follow-up is kept on all check payments.

Window Payments

Window payments include the delivery of the cashier's checks to payees who call at the window (as stated in the fourth method described above), and also the cashing of checks drawn on the bank by foreign depositors. In making such payments identification is very important as most of the payees are foreigners. Identification is made through third parties or by means of passports, specimen signatures, etc. Before checks drawn on the bank are paid, they are forwarded to the bookkeepers, where the signatures are verified and the checks are marked off the bills payable ledgers.

The window teller obtains his cash each morning, and, if necessary, at other times during the day, from the paying teller of the domestic division on memorandum receipt. During the day he receives the money coming in through the foreign draft, cable transfer, and receiving teller's windows. This gives him a good working balance. In the evening he returns the cash to the first teller against credit receipt.

The window teller also keeps the brokerage book in which he makes entries in connection with the contracts to buy or sell bills. The transactions are briefly described therein and the amount of brokerage is paid by cashier's checks, say, once a month.

Another duty of the window teller is to keep the due book and, on the proper date, make payment on the bought contracts.

The Handling of Bought Contracts

The term "contracts" covers transactions originating with the traders, whereby exchange is bought or sold for demand or future delivery, in the form of drafts or cable transfers.

The bought contracts are obligations to receive and pay, either at once or in the definite future, cable transfers or bills. The contract is signed by the trader. The conversion from the foreign currency to dollars is made at the given rate. The purchase is confirmed to the seller by the foreign tellers' department; this confirmation also instructs the seller as to the party to whom payment is to be made for the bank's account. The duplicate copy of the confirmation is attached to the contract.

On the basis of the bought contracts the receive sheet is prepared in duplicate. This sheet shows the name of the bank bought from, the bank to receive, and the amount in foreign currency. The duplicate goes to the window paying teller, who handles the bought contracts; he follows up the banks to which the department has wired to receive credit on their books for all contracts bought. The original instructions are then handed to the cable department, which prepares the cables and checks them against the receive sheet.

The original instructions are now handed to the window paying teller, who enters them in the due book under the date when, by the terms of the contract, payment is to be made. On that date he prepares the necessary tickets, charging the foreign bank that has been wired and crediting Cashier's Check account. The cashier's check is prepared and forwarded to the party from whom the exchange was bought.

Cable transfers are paid for on the day the bank receives its credit abroad. In case bills are bought instead of cable transfers, the above-mentioned cabling need not be done. Bills bought by contract are, unless otherwise specified, paid for on steamer day.

The Handling of Sold Contracts

Sold contracts are obligations to deliver, at a price, at once or in the definite future, cable transfers or bills. The contract is made and signed by the trader handling the transaction. The cable transfer clerk makes the conversion to dollars and enters it in the tickler under the date when the money is due in New York or abroad, as the case may be. The bill is made out in duplicate, the duplicate is attached to the contract, and the original is sent to the customer to whom the exchange is sold. If confirmation comes in due course, about two days before the money is due abroad the bank's correspondent abroad is cabled to pay the institution named in the confirmation.

The cable transfer clerk lists on his cable sheet the pay cables under the names of the foreign banks which are to make the payments and the cable department wires on the basis of the original contracts. These two records are checked daily. The foreign receiving teller is provided with a tickler to keep him informed as to the amounts due and from whom, and before the close of day he notifies the cable transfer clerk of any payments due and unpaid, so that they will be followed up.

When bills are sold for future delivery, the bank confirms the sale as having been made "through . . . . at . . . . . . for steamer sailing . . . .," and asks for a confirmation. When drafts are sold by contract to a bank, payment will, unless otherwise stipulated, be made on steamer day only, and the drafts will be drawn and delivered on the day before steamer day.

Investigations

The handling of investigations and the correspondence connected with them is not only a very responsible function, but also, from the standpoint of the bank's clients, is regarded as an index of ability to render service. Correspondence, cables, etc., which have reference to past transactions or which indicate that a transaction has not been handled at all or has been handled incorrectly, are handed to the investigation clerk. He sorts the investigations on the basis of their importance, the more important being handled first by his assistants in the manner which he feels will produce the best results and the best service.

CHAPTER LIX

FOREIGN COLLECTIONS

Classification of Foreign Collections

The collections handled by the foreign division divide themselves into two distinct classes—those payable inside the United States and those payable abroad. As the methods of handling them differ greatly it is the common practice to allot them to different departments. The names of the two departments vary among the banks; one bank may call them "incoming collection department" and "outgoing collection department," another "import collection department" and "export collection department." Neither of these nomenclatures is altogether fitting. In this chapter collections payable inside the United States will be called "home items" and those payable abroad "foreign items," and the operations in collecting the two kinds will be described in that order.

The Collection of Home Items

The collection of home items covers the handling of those drawn on domestic parties and sent to the bank by its branches, correspondents, or others, for collection, and the placing of the proceeds according to instructions in their remittance letters. Most of the items are received through the mail, a few only coming over the window. Where the depositor has an agent or branch in the city, its out-of-town items may be sent through the incoming collection department. The items are of three classes: (1) cash items, (2) collection items, and (3) discount items, the handling of each class having its own peculiarities.

In summary, the work consists in checking the incoming mail and marking the remittance letters for cash, collection, and discount items; making proper entries and sending proper advices; preparing the bookkeeping tickets; putting the items into the hands of the proper department of the domestic division for collection; receiving the remittance and making proper disposition of the funds; and making any investigations that may be asked by customers as to the course of some remitted item.

The internal organization of the department is affected by certain facts contrasted with the collection of the foreign items. The department is concerned almost wholly with incoming mail; it prepares no remittance letters, but sends its items to the transit, country collection, and note teller's departments. The incoming mail comes very irregularly, as the steamers arrive. The department must, therefore, be elastic and mobile, and be able to concentrate its whole attention at certain times on checking and getting a batch of mail under way. In early morning, also, many of the clerks may assist the regular mail checkers, and later turn to their specialized work. Since the items are in dollars and against domestic concerns they may be entered with much less detail than the foreign items.

A useful expedient to handle the items may be their division into the three classes of cash, collection, and discount items; or their division on a functional basis among the following clerks: a regular item clerk, a special and documentary item clerk, a protest and unpaid item clerk, a discount clerk, an entry clerk, a drawees' book clerk, a credit advice clerk, a credit ticket clerk, a duplicate clerk, an overdraft clerk, a customers' card clerk, and mail checkers. The same clerk may, of course, perform several of these duties.

The Handling of Cash Items

Cash items comprise the following subdivisions:

1. Items drawn on the bank by other parties.
2. Clearing house items, that is, items drawn against members of the local clearing house and collectible through it.

3. Large sights, that is, items which are drawn at sight against concerns located in the district of the city collection department, for an amount of, say, $1,000 or more, and which therefore warrant immediate collection by messenger.
4. Small sights, that is, similar items for amounts less than $1,000.
5. Treasury items, which are items drawn at sight against the Treasurer of the United States and are collected through the federal reserve bank.

All cash items are drawn in dollars, at sight, without documents, items not so drawn being handled as collection or discount items.

Early in the morning checkers check the cash items on the remittance letters; that is, they designate after each item the drawee; for clearing house items the clearing house number of the drawee is used, and for the others some abbreviated designations. The cash items are then sorted into the five classes above mentioned. The totals of these five groups of items are proved in batches, as convenience warrants, against the total amounts of the cash letters. The items are finally disposed of as follows: The items against the bank itself are sent to the check desk of the domestic division, as are also the clearing house and treasury items; the large sights are sent to the city collection department, and the small ones to the foreign tellers' department.

The foreign bookkeeper's department uses the remittance letters as credit tickets and posts the totals of cash items directly to its ledgers. The letters are then given to a typist, who prepares the proper credit advices. If the transaction is a straight credit, an advice is sent to the remitter only; but if it is a cross credit, both the remitter and the beneficiary are advised hat funds have been placed at the disposal of the designated beneficiary.

Cash items are credited to the account on the day they are received by the bank. This is an advantage to the beneficiary, for if they were taken on a collection basis credit would be delayed until proceeds were realized.

Items are often returned unpaid through the city collection department, which has charged the foreign collection department with the face amount. The foreign collection department then debits the account formerly credited and recovers the relating credit advice before it is mailed. If any of the unpaid items warrant it the department, unless otherwise instructed by the remitter, has them protested. Items returned, whether protested or not, are held in a return box a week or ten days before they are returned to the remitter. This delay gives the drawee time to communicate with the drawer and possibly to arrive at an agreement to honor the draft before it is returned. In the case of both cash and collection items for, say, $500 or over, which have not been accepted or paid, the department cables advice to the remitter unless specifically instructed to the contrary. This advice enables the remitter immediately to protect his interests if the refusal to pay or accept be inimical thereto.

The Handling of Collection Items

Collection items consist of the following:

1. Items drawn in foreign currencies.
2. Checks payable anywhere in the United States and Canada.
3. Items drawn at more than sight, ranging from one day up to, say, six months from sight or date, as the case may be.
4. Items received without a draft, that is, bills of lading, insurance policies, and other negotiable documents received with a request to surrender them to a named party upon payment of a stipulated sum of money.
5. Drafts with documents attached.

The mail checkers ring these items on the remittance letter if they are listed with the cash items; but if listed on a separate letter, the items are kept with that letter. Each item is stamped with a collection number after its notation in the collection register. In this register data about the draft or document are entered in columns which record: their number, our number, the remitter and his address, the beneficiary and his address, the instructions, amounts, tenor, date of acceptance, date of maturity, documents attached, place where payable, and fate. The beneficiary may or may not have an account with the bank; in the latter case he is paid either by draft or cable transfer, according to the instructions.

After the item is entered in the collection register, entry is made in the drawees' book, which gives the following information: the name of the drawee, the date of receipt, the amount, documents attached, the number, and the tenor. If the draft is drawn in a foreign currency, it is converted into dollars at the rate specified by the traders. The accuracy of this conversion is carefully checked. Should the drawee be dissatisfied with the conversion rate used by the department, he may buy a prime banker's check on London in the market and tender this in payment.

The final disposition of the items is to send them, along with the collection register sheets, first to the note teller, who signs for the accepted time items, then to the fifth teller, who signs for the items payable in his district, and last to the country collection department, which signs for the items payable outside the collection district of the fifth teller. The collections are made through these departments.

From the collection register sheets entries are made on customers' cards, containing the following data: their number, our number, name of drawee, amount, tenor, date received, and fate. From these cards it is possible to ascertain the amount outstanding or collected for any particular account in any one period.

The three departments named above as signing for the items know them only by number and not by the name of the ultimate beneficiary. Therefore for the proceeds received they credit Collections account with the amount in bulk, and send the foreign collections department a credit ticket with the net amount collected and the number of the item. This department then fills in the further particulars, namely, the name and place of the account to be credited and the date of the remittance letter. From these credit tickets credit advices are prepared. Before the advices are sent out they are used to stamp out on the collection register the fate of the item. The stamping out of these items is a further check on the department's work as to correctness of beneficiaries' names and addresses; the credit advices then go to the foreign bookkeepers, who also check the amounts against their records, and are finally given by them to the outgoing mail department.

A charge is commonly made for the collection of all drafts to which are attached shipping documents, because they require extra attention. Clean drafts are collected free of charge, as far as the clearing house or federal reserve collection rules permit.

A great many duplicate drafts are received, which, after the originals have been paid, are worthless. If the originals go astray the duplicates become important. In order to know whether the originals have been received the department keeps a duplicate book. When duplicates arrive reference is made to this book, and if the originals have come to hand the duplicate drafts are marked "Original Paid," with date of payment, and filed according to dates received. Special instructions from the drawee or indorser may lead the department to dispose of the duplicates in some other way. If the originals have not been received, the presentation and demand for the payment of the duplicates are made.

The Handling of the Discount Items

Discount items are those sent to the foreign collections department in order to have them accepted by the various drawees, to have them discounted. upon advice of the remitter or in case it is necessary to cover an overdraft or in accordance with some other specific instructions, and to place the proceeds to the credit of some designated account. In some cases the bank has standing instructions from the correspondent to discount acceptances which it is holding, whenever the correspondent's account is reduced below a certain figure.

The method of executing these discount orders is first to prepare an offering slip giving the following data: amount of the item to be discounted, name of the remitter, name of the drawee, tenor, the discount rate, the date of maturity, and the last discount rate. The offering slips are passed upon by the officers, who, upon consultation, fix the discount rate for each item. When the offering slips are returned, a clerk calculates the discount and proceeds and the total proceeds to be credited to the customer. The proper credit tickets and advices are then prepared; the advice is sent to the beneficiary; and the tickets, together with the items, to the domestic discount department to be held until maturity.

A card record is kept for each bank and individual for whom the bank discounts acceptances. The information on these cards covers the amount, the rate, the maturity date, and the number stamped on the item. Another card record is kept of the drawees of the bills which have been discounted, giving the amount of the bill, the stamped number, the tenor, and the maturity date. By this record the department can ascertain at any time the total amount discounted for any drawee and the amount outstanding against any particular drawee.

The Collection of Foreign Items

Foreign items are items due from and payable in foreign countries. The collections are received from and made for both domestic and foreign customers, as well as for the bank itself. Few of the country or interior banks have a volume of foreign collections large enough to warrant the establishment of foreign connections with a view to making their own collections, and non-banking parties have still less warrant for such action. The metropolitan bank can, therefore, perform an invaluable service for bank and non-bank clients by acting as their foreign collection agent, and the concentration of the business of many clients makes for economy by reducing the overhead per item.

A bank may establish uniform or varying rates of commission for collections. A not unusual plan is to fix the rate, say, of 1/8 per cent, and not to let the department change the rate unless specifically authorized in the case of some particular item or client. Though the department does not usually earn enough to pay for its maintenance, the net deficit is regarded as an investment in good-will.

The collection of foreign items requires a record of their despatch and the receipt and disposition of the payment for them. The items are received, acknowledged, registered, indorsed to selected correspondent collection agents, listed on remittance letters, and despatched with the remittance letters and accompanying documents. A tickler and follow-up for such remittance letters are kept until later when advices of payment or non-payment or of acceptance or non-acceptance are received, and still later when payment is received and acknowledged and the customer is paid by cashier's check or credit to his account. To handle the work the following clerks may be required: a window clerk, a register clerk, an indorsement clerk, checkers, an acknowledgment clerk, a tickler or follow-up clerk, a check clerk, and investigators.

The Receipt and Entry of the Items

The items are received through the window and from other departments. Collections received from individuals, firms, or banks that do not keep an account with the bank are referred to an officer before their collection is undertaken. If they are acceptable to the management, the department is instructed to "receive from and for the account of" the specified parties, and this card is filed for future reference. The window clerk may underline any special instructions contained in the letter of instructions lest they go unnoticed. Documentary collections require special attention in order to see that all the documents are in order.

It is also necessary to determine whether drafts received from domestic clients require documentary stamps. Under the Revenue Act of 1917 stamps are not required if the drafts cover export shipments other than those to the insular possessions of the United States or if drawn at sight; otherwise, stamps are required at the rate of 2 cents per $100 or fraction thereof. Each collector is under license by the Collector of Internal Revenue to collect the income tax; he is also the source of information as to the ownership of items collected.

When all the details described above are in order, the window clerk stamps the item and all accompanying documents with a stamp bearing the name of the bank and the collection number assigned to the item. The item is then passed to the register clerk, who enters it in the bill register book under the following heads: the collection number given it by the bank, the collection number given it by the client, from whom received, for whose account received, name of the drawee, address of the drawee, correspondent to whom sent, amount, tenor, acceptance, due date, advised, date of advice, fate, and to what bank the collection is to be forwarded.

The Tickets and Remittance Letter

Documents must be forwarded in the mails of the steamer carrying the merchandise to which the paper relates, and when documents are attached to any of the collections this fact must be taken into consideration. If duplicate drafts or documents are to be sent they must be separated from the original and forwarded by a subsequent mail in order to insure the safe delivery of at least one set.

The items forwarded to correspondents are indorsed by special or blank indorsement stamps and are signed by someone authorized to sign for the bank. The following are then prepared: an acknowledgment of receipt of the item for collection, a debit ticket, a credit ticket, and an advice of payment to be sent to the client when the payment is received. The preparation of these documents may be economically done by the use of fan-fold copies.

In order to protect the bank the acknowledgment of receipt of the item for collection contains the following notice:

> Please read this advice carefully; if not correct notify us at once; always give *our number* when communicating with us in connection with this item. In connection with this collection, we will exercise care in the selection of responsible correspondents and sub-agents as in the course of our own business, but shall not be liable for any neglect or default of any correspondent or sub-agent so selected or any loss of such paper or its proceeds during transmission.

In the remittance letter are specified the bank's collection number, the amount, the city where the collection is drawn, whether the item is to be protested, the tenor, the documents attached, and any special instructions received from the client, such as "cable payment," "in case of need refer to........," etc.

The letters, with enclosures, are finally assembled and sent to the outgoing mail department; if coupons or bonds are enclosed, they are sent to the registered mail department with instructions to cover by insurance. If time drafts are enclosed, a return form postcard is included which the correspondent or branch is asked to fill out and mail when the draft is accepted.

The client's letter and the tickets are filed, the latter in special compartments, the credit tickets according to the beneficiary or client remitter and in consecutive order according to the bank's collection number, the debit tickets under the name of the country where payable and in numerical order. The acknowledgments are sent to the mail department, to be forwarded to the remitter.

Record of the Items Between Transmission and Payment

When an acknowledgment is received from the correspondent or branch, a clerk checks the number which has been given the item with the number on the bill register book, also the amount and the correspondent's name, and the acknowledgment is stamped with the date. The client is advised of all bills on which advice of acceptance is received from the correspondent or branch, and on this advice are entered the bank's collection number, the client's collection number, the amount of the item, the correspondent's name, where drawn, and the date of acceptance. In the bill register are entered the date of acceptance, the date of the bank's advice to the client, and the date of the advice received from the correspondent.

The tickler clerk keeps a diary, in which entries are made as of the approximate date when each transaction should be attended to. When that day arrives, the bill register is examined to see whether the item has been paid or returned unpaid, or accepted or returned without acceptance, etc. If it has been duly executed, the item is crossed off the diary; but if no notation is found, the debit ticket in the files is examined to see whether any instructions have been given by the client to allow an extension of time, or whether any advice or refusal to pay or accept has been received from the correspondent. If instructions are found to extend the time, say, 30 days, it is so extended on the diary. If no advice has been received, a tracer is sent to the correspondent and an advice to the client that no advice has been received and that a tracer is being sent.

Payment of the Collection

When payment advices are received from the correspondent or branch, the payment clerks extract the proper debit and credit tickets from the files and proceed to the proper distribution of the funds.

If the payments, according to the advice, are in dollars, the bank charges the account of the correspondent or branch with the amount designated; the clerks specify on the debit ticket the date of the advice of payment, the correspondent's collection number, and the value date. This information is required in order to enable the correspondent to reconcile its account when it receives later the statement of its account with the bank.

If the payments, according to the advice, are in foreign currency, and it is specified that the funds have been credited by the correspondent or branch to the bank's account with it, the bank is obliged to charge that account. The clerk enters on the ticket the letter date, the bank's collection number, and the value date, which is in this case the date of the correspondent's advice to the bank. The amount is converted into dollars at the buying cable rate for that day as procured from the traders.

When the bank is instructed in the advice of payment to debit the correspondent's account for the proceeds, reference is made to the bookkeepers to ascertain whether the correspondent has sufficient funds, and a hold is put through. In case of an overdraft, it is referred to a bank officer, who decides whether to allow it or not. If he knows the account is a good one he may initial the overdraft slip at once, and then it is a proper debit to the account; but if he does not know the account well, he will give instructions that the other departments be canvassed to find if funds are due the account.

The corresponding credit tickets are next prepared, together with the advice of payment. On these are entered the charges to be deducted, namely, the bank's commission, the correspondent's commission, stamp charges, discounts, authorized deductions, cable charges, and exchange charges. The payment advice is dated as of the date the account is charged. Credits are put through for the client's account, Commission account, and for the other charges. The advice is then referred to the bill register, and the corresponding number and amount are stamped "paid." The date of advice of payment is also entered, as well as the correspondent's collection number if one is mentioned. If an account is to receive credit, the advice is sent to the client without further notation; but if a cashier's check is sent in payment the check must be checked against the corresponding advice. All such advices are then sent to the outgoing mail department.

When the bank receives from its correspondent, in payment of collections, a check drawn on New York, it is essential to ascertain, prior to making payment, whether the check is good. Sometimes in accordance with the request of a client that the bank be advised by cable when an item is paid, an advice to this effect is received from a correspondent or branch.

When the proceeds of collections are to be paid to the client by cashier's check rather than by crediting his account, the checks are prepared. If more than one payment is to be made to a single concern, the tickets are totaled and one check is given for the total amount.

Items returned by a correspondent or branch unpaid are turned over to the payment clerks, who debit the account of the parties to whom the item is returned, provided they have an account with the bank, for the charges abroad and for the bank's commission, and credit the account of the correspondent and the Commission account. When the concern to which the bank must return unpaid items has no account with the bank, a different form of ticket is used to signify that the bank is to receive cash or a check from these people. These tickets are held until the funds are received, when they are put through in the regular way.

The returned unpaid items are stamped off the bill register book by putting in the "fate" column the date when the item was returned unpaid; and the items that have been paid are stamped off by entering the date of payment, the date of the advice of payment received from the correspondent, and the correspondent's collection number.

The client is advised of items unpaid or unaccepted and retained for further instructions, and is requested to send immediate instructions. When the necessary instructions are received the correspondent is advised accordingly. Items unpaid, or unaccepted, and returned by the correspondent, are returned to the client, with a letter giving the reason for such return. A charge of, say, 50 cents is added to the charge of the foreign agent, and the client advised that his account has been debited by a certain amount, or he is requested to send a check on New York or postage to cover.

CHAPTER LX

COMMERCIAL LETTERS OF CREDIT

Nature of Commercial Letters of Credit

In commercial language, a commercial letter of credit entitles the taker, or a third party, to "commercial credit," "banker's credit," or "acceptance credit," as it is variously called, at the issuing bank or its correspondent. A commercial letter of credit is a grant by letter or cable authorizing an individual or firm to draw drafts on the issuing bank or its correspondents, for its account, under certain stipulated conditions. The letters are used:

1. To finance transactions involving the exportation and importation of merchandise, that is, to finance the production, transit, and marketing of goods for export and import.
2. To finance the domestic shipment of goods, against shipping documents covering goods in transit.
3. To finance the domestic storage of readily marketable staples in warehouse.

Domestic credits are not intended by the Federal Reserve Act to finance the production of goods. An export or import credit is in effect a guaranty by the bank to the seller of merchandise that his drafts covering certain merchandise and drawn in accordance with the conditions prescribed in the credit will meet with due honor on presentation to the accepting bank named in the letter of credit.

The general nature and uses and the legal phases of commercial letters of credit and banker's acceptances have been presented in Volume I, Chapter IX, and Volume IV, Chapter L, and also in the present volume, Chapter LIV. In these chapters it is shown that the use of such instruments is one of the methods by which a bank extends its credit; that they are designed to provide short-term, as against long-term, credit; that they are designed to supply an assured credit for carrying goods in storage, production, transit, and marketing; that they should cover essentially self-liquidating transactions; that the banker should retain, ordinarily and as far as practicable, the control over the goods, and should receive and apply the proceeds to the retirement of the bills when due; and that the maturity of the bills drawn under the credit should synchronize with the prospective liquidation of the transactions.

Advantages of Their Use

The advantages of the use of letters of credit are numerous. The most important benefit to the seller of the merchandise is that he is authorized to draw against a well-known bank instead of against the less known importing house. This enables the drawer to command a better price for his draft, as it is a banker's prime bill instead of the more risky commercial bill; and since the drawer is able to convert his draft at a good price and at any time, he enjoys a competitive advantage over those who do not use bankers' credits. Other advantages are that the buyer of the goods is not required to make payment until maturity of the draft and can often realize on his purchase before the acceptance falls due. The bank which issues the credit is in a position to weigh the credit title of the buyer and, if the circumstances warrant, to turn over the documents (virtually, the goods) in advance of payment. The buyer is, therefore, able to do more business on his capital. The fact that the bank grants credits to the buyer of the goods usually indicates that he enjoys a high standing in the business world. The general result of these facts is that, by the reduction of risks, business can be more freely transacted and on a lower price basis.

Another advantage arising from the use of bank credits is the greater liberality extended by law to this kind of financing. Prudent banking practice and banking laws have drawn a distinction between money borrowed and bankers' acceptance credit. The amount of the loans a bank may make to one person, firm, or corporation is specifically limited to a percentage of the capital and surplus of the bank; but there is no limitation to the amount of accommodation that may be granted by a national bank to one customer through discount of commercial paper actually owned by him.

These legal preferences are based upon the self-liquidating and commercial character of acceptances. Borrowed money is often considered and used as invested capital, unless the loan is for seasonal requirements or specific purposes, and borrowings as a class are not always highly liquid. Bankers' acceptances are, on the other hand, "based on current commercial transactions, within limitations designed to minimize credit risks." There is greater reason for expecting their retirement at maturity than is the case with an ordinary loan. If the acceptance is secured, the collateral may be liquidated quite easily in its broad market; and if it is not secured, the completion of the underlying transaction, barring failure or fraud, will automatically provide funds for its retirement. The banker is also conversant with the details of the transaction because he sees either the documents covering the goods or the contracts to export or import. The law requires that the acceptance shall arise out of a commercial transaction.

Classification of Commercial Credits

A recent study made by the division of analysis and research of the Federal Reserve Board classifies commercial credits as follows:

> The *import* letter of credit is the authorization addressed to the beneficiary in one country by the credit-issuing bank in

another under which the former is given the right to draw drafts up to a specified sum and within a definite time, and the latter undertakes to honor the drafts when presented. The *export* letter of credit is the advice from a bank to the beneficiary that a credit has been opened in his favor by a foreign bank and that the notifying bank agrees to honor drafts drawn by the beneficiary.

Letters of credit may be classified also according to their terms and conditions. If a bank agrees to honor drafts drawn by the exporter only when accompanied by satisfactory bills of lading, consular and commercial invoices, the statement is called a documentary letter of credit. It is termed a clean or "open" credit if such stipulations are not mentioned.

A broad basis of classification of letters of credit rests on the right of the issuing bank to rescind its engagement to honor drafts drawn by the beneficiary. If the credit-issuing bank reserves the right to withdraw from the undertaking, the document is styled a "revocable" letter of credit. The "irrevocable" letter of credit contains a definite engagement on the part of the issuing bank to honor drafts drawn by the beneficiary in accordance with the terms and conditions specified in the letter. This engagement may not be canceled by the issuing bank prior to the expiration date without the consent of the beneficiary. The "irrevocable" letter of credit may be strengthened further by having the notifying bank in the same country as the exporter add its unqualified assurance that it will pay or accept the bills drawn by him even if the foreign bank should refuse to honor them. It is then called a "confirmed" export letter of credit. Expressing, therefore, both the definite undertaking of the issuer and also of the notifier, it is actually an "irrevocable-confirmed" letter of credit. Where the notifying bank does not add its guaranty, the credit is described as "unconfirmed," since the advising bank maintains that it is merely transmitting the information of the credit to the beneficiary without incurring liability for its continuance. Thus three classes of letters of credit may exist: (1) Irrevocable by the issuer and confirmed by the adviser; (2) irrevocable by the issuer but unconfirmed by the adviser; (3) revocable by the issuer and also unconfirmed by the adviser.

This classification is a departure from the usual precept that the terms "confirmed" and "irrevocable" are synonymous as applied to commercial credits. However, while writings on this subject accept the twofold grouping of confirmed or irrevocable as against unconfirmed or revocable credits, actual banking practice operates on the classification given above.[1]

Confirmation may be made in numerous ways, as by signing the instrument to that effect, or by letter or cable. The seller of goods when negotiating his draft prefers to have the letter confirmed, for there is then no question of his authority to draw and the draft can be sold more readily. He may also be engaged in the manufacture of an article that can be used only by the client ordering the goods, and to cancel the credit may destroy the market. It is, therefore, advisable for him to have a confirmed credit established which cannot be revoked except with the consent of all parties interested.

Naturally the bank opening the credit will not confirm a credit unless expressly instructed to do so by the party at whose instance it is opened, for the bank thereby assumes a contingent liability. In establishing an unconfirmed credit both the opening and the issuing banks reserve the right to cancel it at any time. Full or partial performance of the agreement on the part of the beneficiary, however, may, upon notice, serve to stop revocation as between the parties thereto, and a refusal of payment by the bank only affords a cause of action for judicial determination. The distinction between confirmed and unconfirmed credits is sometimes a fine one, and great caution is exercised by the commercial credit departments that they refer all matters pertaining to confirmation to the officers of the bank.[2]

The Federal Reserve Board in its investigation found that most import credits issued by American banks are irrevocable. Many banks have adopted the policy of opening no revocable import credits whatever since cancellations, even though justified, tend to impair the credit standing of the issuers. Export credits

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[1] Federal Reserve Bulletin, Feb. 1921.

[2] For analysis of legal rights and responsibilities arising out of commercial letters of credit see the Federal Reserve Bulletin, Feb. 1921, pp. 158-164.

are somewhat less commonly confirmed than import credits, and acceptance or time credits are ordinarily confirmed.

Another line of classification is to specify the character of the instruments that will be accepted. A *straight* or *simple* credit is an advice to the beneficiary that the bank will honor his draft at sight, against documents specified. These credits are the usual ones and may be confirmed or unconfirmed. On payment of a straight credit the department charges the account of the foreign bank on the same date, plus its commission and other charges incurred.

An *acceptance* credit is an advice to the beneficiary that the bank will accept his time drafts on it, either clean or accompanied by the documents specified. Clean time drafts cannot legally be accepted unless the proceeds of the drafts are used to finance the importation and exportation of merchandise. Such credits may be confirmed or unconfirmed and differ from the *straight* credits in that they recite the tenor of the draft, with the words "to be accepted." When the bank accepts a draft under such credit its responsibility for payment at maturity is fixed.

A *negotiation* credit is an advice to the beneficiary that the bank will negotiate his draft on a foreign concern as instructed by the bank's correspondent, be it sight, 30 days, 60 days, or a longer period. When the draft is presented with documents attached, the bank buys it and pays the face amount less the following charges: the discount for the period of the draft, plus the time it takes the instrument to reach the drawee abroad and the time required for the collected amount to return to the bank; the charges for bill stamp, if any; and the bank's commission. The operation is simply the purchase of a bill of exchange with documents attached, but the bank has the added assurance that the bank abroad which authorized it to purchase the bill is satisfied that the drawee is solvent and responsible. Thus it occasionally happens that the bank will negotiate bills under this arrangement which it might refuse to buy for its own account and rely only on the drawee's honoring it. Under this form of credit the bank is instructed by its correspondent as to the documents to require from the beneficiary and is given particulars concerning the merchandise to be shipped. Such an arrangement best serves the foreign buyer and safeguards the interest of the bank and its correspondent.

A *reimbursement* credit is a straight credit opened through the bank by banks or individuals who may have no account with the bank but whose standing and responsibility warrant the bank in according them credit recognition. After payment has been made according to instructions and the terms of the credit, the bank draws its own drafts against such banks or individuals for reimbursement of its outlay.

A *guaranty* credit is an advice by letter, but without responsibility on the bank's part, to an exporter that his draft up to a certain amount will be duly honored by the bank's foreign correspondent on arrival of the documents at their destination. If the exporter desires it, the bank will take the documents without making payment and forward them to the foreign correspondent, who will later instruct the bank by cable or letter to pay the beneficiary the amount involved. In some instances remittance is made directly between the parties or through intermediaries. In other instances, if the beneficiary of a guaranty credit wishes the bank to purchase his drafts, the bank will do so at very favorable rates. In handling them the bank assumes slight risk, as payment is guaranteed by the foreign bank.

A *revolving* credit is a credit established for a certain amount which as drawn against in stipulated or unstipulated sums is automatically replenished by the fulfilment of certain conditions, such as the payment of outstanding drafts, and against which further drafts may then be drawn. There are several forms of revolving credit:

1. The most common form is that established for a maximum amount against which drafts may be drawn for various sums and at various times against documents indicating shipments. When these drafts are paid, their amount is restored to the credit for further use; should the entire credit become exhausted, further drafts must await reimbursement of the original amount.

2. A second form enables the beneficiary to draw a certain sum at one time and in one draft; when that draft has matured and is paid, a similar sum may be drawn in a similar way.

3. Under a third form the credit must be drawn against in one bill for the full amount, whereupon it becomes immediately available again for a similar drawing, and so on until the time limit is reached.

4. A fourth form is credits under which the beneficiary can draw a certain maximum amount within any one month or week or whereby a shipper can draw up to a certain amount covering shipments by any one steamer.

There are many minor subdivisions in the above classifications of commercial credits, as the credits are always made to fit the peculiar conditions under consideration and a great variety of adaptations is possible.

Authority to Purchase

Exports to the Far East are largely financed by means of authorities to purchase, whereas very few imports are thus covered. Accordingly, American banks rarely, if ever, issue authorities to purchase, but act as notifiers of authorities and payers of drafts under them. Only the banks of New York and San Francisco are well acquainted with authorities to purchase, the large majority of which are drawn on a time basis—to run 60, 90, or 120 days' sight, and are made payable in United States currency.

The development of the authority to purchase was forced by the inadequate banking facilities of the Orient, where until recently it was almost impossible for an importer to secure a bank credit to finance his importations. As a letter of credit was not used, it was necessary for the American exporter to draw directly on the Chinese importer, who, in order to create a market for the exporter's bills in America, informed his local Chinese bank that he had authorized the exporter to draw drafts, and requested it to arrange for the negotiation of these bills by a branch or correspondent bank in the exporter's vicinity. The importer undertook to provide funds to retire these drafts at maturity, to provide collateral to secure the bank's interests, and to compensate the bank for its services. This letter given by the importer to the Chinese bank is properly called a "letter of guaranty," and functions both as an application and guaranty. If the Chinese bank approves the application it cables instructions to its American branch or correspondent to negotiate the drafts drawn by the American exporter on the Chinese importer, and follows this up with a letter reciting the instructions in detail. This letter, known as the "authority to negotiate" or "advice to purchase," constitutes the real authority to the American banking house, which then issues to the exporter an 'advice of authority to purchase," informing him that he may draw on the importer and that it will negotiate the drafts presented together with the proper shipping documents. In some cases the advice of authority to purchase is sent directly by the Chinese bank to the exporter, and not through its American agent. The importer sends to the exporter an "authority to draw," reciting the terms of sale and the right to draw on the former, but the banks are not concerned with this commercial contract between buyer and seller. But to the other three documents—the letter of guaranty, the authority to purchase, and the advice of authority to purchase—the banks are parties.[3]

[3] For forms, as well as further description, see Federal Reserve Bulletin, Aug. 1921, pp. 929–930.

While authorities to purchase may be: (1) irrevocable by issuer and confirmed by notifier, or (2) irrevocable by issuer and unconfirmed by notifier, or (3) revocable by issuer and unconfirmed by notifier; and while, in case the importer dishonors the drafts drawn on him: (1) the Chinese bank may reserve full recourse on the drawer, if it issues the authority directly to the drawer; (2) the American bank may have full right of recourse on the drawer, if the authority is placed through it as agent of the Chinese bank; and (3) the American bank may have full recourse on the issuing Chinese bank until final payment; the majority of authorities are revocable in form and call for drafts carrying full recourse on drawers.

It will be observed that, like letters of credit, these authorities shift the burden of financing the transaction from exporter to importer or his bank. They are somewhat similar to letters of credit drawn documents against payment, for the exporter is paid upon the presentment of the draft and the surrender of the documents. Like a letter of credit, an authority to purchase is based on a conferment upon the exporter of a right to draw, and both require the same shipping documents.

Although the two instruments are much alike, however, the authority to purchase is used only in trade to the Orient, largely in the export trade, whereas letters of credit cover both exportations and importations, from and to all parts of the world. Then, too, letters of credit provide for drafts drawn at sight or on time, in dollars or in foreign currency, whereas authorities provide only for time dollar drafts. Letters of credit are usually irrevocable and allow the drawing of drafts practically without recourse to the beneficiary, whereas the authority is usually revocable and the issuer reserves full recourse on the drawer. Finally letters of credit give rise to bankers' bills and acceptances, whereas authorities occasion commercial bills and trade acceptances, for which the discount market is more limited and discount rates higher.

Dollar Credits

A further line of credit classification is the currency in which the credit is given and the drafts drawn. They may be drawn in sterling, francs, marks, or other foreign currencies, or in dollars. Prior to the outbreak of the war in Europe fully 99 per cent of the credits issued to cover importations and exportations of the United States were sterling credits. Requests for the issuance of credits available by drafts drawn in United States dollars on New York banks were extremely rare and were issued only in exceptional cases.

Conditions have changed materially in this respect. Not until 1914 were national banks privileged to accept drafts drawn on them, and their privilege is still quite restricted by law. The development of dollar credits has also been delayed by certain banking conditions. American banks are relatively little known abroad and dollar drafts were until recently nearly unknown. Banks in foreign countries, as for instance, in Brazil, would not pay as good a price for dollar drafts as for sterling drafts and the Brazilian exporter would therefore insist upon sterling credits. English and continental banks had established great systems of branch banks, which would invariably draw drafts in foreign currencies, push the use of such credits, and not encourage the use of dollar credits, whereas American banks had, until recently, no foreign branches whatever, and even now only a few of the larger institutions have branches and the number of these branches per bank is relatively small.

Moreover, before the war the rate of discount was generally lower in London than in New York, and sterling bills in foreign countries would therefore sell for higher prices than dollar drafts. Custom and business inertia favored the continuance of foreign currency credits. American bankers were also influenced by the facts that foreign remittances were more easily made in sterling than in dollars and that under foreign credits they earned their commissions without accepting themselves, the direct liability of the acceptance being undertaken by the foreign bank for account of the issuing bank.

Advantages of Dollar Credits

The war created conditions which favored dollar credits, and it became more economical to use them than sterling or continental credits for the following reasons:

1. The commission on issuance is lower; only one commission, that to the New York bank, is paid under dollar credits opened directly, whereas two commissions, one to the New York bank and another to the foreign bank, are paid on sterling or continental credits. This saving of commission will undoubtedly accrue ultimately to the customers when competition makes it impossible for a bank to retain both commissions.

2. The dollar credit is based on the dollar, the value of which in the United States is known and relatively stable as compared with the recent extreme and violent fluctuations in foreign exchange rates; dollar credit shifts the risk of fluctuation to the foreigner; the price quotations to the American importer and the quotations by the American exporter are, in the majority of cases, in terms of dollars; maturities drawn under dollar credits are due and payable in dollars on given dates, and no question arises as to what the exchange rate on London may be a certain number of days before the maturity of the bill. This advantageous position will last only so long as the United States is a sellers' market.

3. The Brazilian exporter under dollar credits is concerned only with the exchange rate between New York and Rio, between dollars and milreis, and, except as an arbitrage consideration, may ignore the New York-London exchange rate and the Rio-London exchange rate.

4. Under dollar credits the bill of lading and all other documents come direct to America, and none of them needs to be sent through London. This direct remission of documents saves delay in getting possession of the goods and prevents the merchan-

dise from going to general order if the goods arrive before the documents, as often happens when the documents are sent through London.

5. The American banker is likely to extend dollar credits more readily and quickly and with better adaptation to needs than he will foreign currency credits, which can be opened only according to prearranged negotiations with foreign correspondents and always with extreme care to maintain his credit rating with his correspondent.

In addition to the consideration of profit other factors such as advertising, prestige, etc., influence the bank in issuing dollar rather than foreign currency credits.

Terms of Issue

The terms of issue are stated in a signed agreement attached to the letter of credit. Under such agreement the taker agrees:

1. To place with the bank funds sufficient to cover the draft and the commission at a certain per cent, 1 day if it is a dollar credit or, say, 12 days if it is a foreign credit, before maturity of the accepted drafts.
2. To insure in a company satisfactory to the bank at his own expense, for the bank's benefit, against risk of fire or sea, all goods purchased or shipped pursuant to the letter of credit.
3. To put in the bank's name title to all property purchased or shipped under the credit until the bills as well as any other due indebtedness are paid, and to authorize the bank to take possession of the goods and dispose of them to best advantage and to charge all expense to the customer.
4. To provide additional security if the market value of the merchandise depreciates below an amount sufficient to cover the acceptance plus commission and interest.

5. To provide collateral of stocks, bonds, warehouse receipts, or other security satisfactory to the bank in case the bank surrenders the documents representing the goods against trust receipt, to be held until the terms of the credit have been fully satisfied.

Other clauses are introduced as to responsibility for errors in cabling, continuance of the obligations despite changes in the composition of the parties to the agreement or in the user of the credit, and the correctness or genuineness of the documents.

The three common conditions under which a bank will undertake to issue such credits and bind itself to accept drafts under them are:

1. On the unsecured promise of the applicant to place with the bank proper and full funds before maturity of the several drafts drawn and accepted.
2. On like promise of the applicant, but secured by pledge of securities.
3. Under guaranty by a third party of acceptable character that the applicant will keep his promise.

Factors to be Considered in Arranging a Commercial Credit

Obviously, the credit title of the applicant is the chief factor in deciding under which arrangement the credit will be issued. Before a bank issues a letter of credit it must satisfy itself that the moral and financial standing of the applicant warrants the extension of a commercial credit, for it involves the granting of credit secured by merchandise in transit; and since the value of this security may fluctuate widely during the period of the drafts drawn under the credit, the bank must weigh not only the kind of merchandise to be shipped but also the credit title of the applicant. Bankers dislike to go to court and seek to recover by legal process from the merchandise security, or even from the customer, the payments made under acceptances.

A line of credit is generally extended for commercial credits only, distinct from the line that covers loans and discounts; but the extension of such a line does not always mean that the bank will deliver documents to the applicants up to the full amount.

When documents are delivered on acceptance, the bill becomes an unsecured credit instrument. The drawer and first discounter of the bill, therefore, consider the credit standing of the drawee and acceptor, to whom they look for payment of the draft; and the credit grantor considers this fact also, when he issues the credit to the taker or establishes a line of acceptance credit for him.

The issuing banker must also know definitely the nature of the proposed transaction so that he can determine whether it will be completed within the period of the credit and is reasonably certain by itself to produce funds at the maturity of the draft, with which to pay the obligation assumed by the taker of the credit. He must also determine whether, under the Federal Reserve Act and the rules and regulations of the Federal Reserve Board, it is an eligible transaction for his bank. In addition he must decide whether the commission he can charge is adequate, all things considered. The rate of commission charged by different banks for the issuance of commercial credits varies according to several factors, chief among which are the credit title of the customer himself, the tenor of the drafts to be drawn under the credit, the nature of the shipments, the service done by the bank as to insurance, etc. The rate is a matter of negotiation between bank and applicant.

The Guarantor

The guarantor of an acceptance credit may or may not be a banker. If he is a foreign banker, he may arrange for his clients' credits with his banking correspondents in foreign countries, facilities which otherwise they might not be able to secure. In such cases, on behalf of his customers, he will probably attend to proper preparation of drafts and documents, collections, etc.

If he is a domestic banker, not himself in a position to accept in sufficient amounts to supply the entire needs of his customers, he will probably act as agent in procuring other acceptors and is likely to act for them in attending to the local details of the business involved, such as holding collateral, receiving and remitting proceeds, etc. He may also negotiate the paper for his customers, but his obligation as guarantor is to the grantor of the credit, generally the acceptor.

His obligation, broadly stated, is to insure fulfilment of the obligation of the taker of credit to provide funds but may include other obligations stipulated as an essential condition to the granting of the credit, such as assurance that funds derived from the credit will be applied only to the uses for which the credit was given, and that the proceeds of the underlying transactions when realized will be applied as agreed.

In such cases the guarantor is paid by his clients a commission which may, or may not, include the acceptor's commission. The acceptor's commission, however, will probably be lower on a credit guaranteed by a banker than if it were not so guaranteed. There may be other profits accruing directly or indirectly to the banking guarantor such as proper charges for exchange and collections, and the benefits accruing from exchange for remittance. Or the guarantor may be a merchant or manufacturer desiring goods available through an importer or producer who for one reason or another, without the granting of these acceptance facilities, could not swing the business in the volume required. Their own lines might be full or too large a margin might be required by their bankers unless they received additional guarantee against loss. Such a guarantor may stipulate a commission or he may act without special compensation, being primarily interested in getting the goods, or to control their market, and for these reasons he may be willing to assist in the financing by guaranteeing the contract of the person that does control their disposition. Or there may be reasons of friendship or relationship that may form the motive for a guarantee of credits.[4]

Guaranty of Letters of Credit Issued for Interior Correspondents

Some national banks have lately acted as guarantors of letters of credit issued at their request by correspondent banks in large

[4] Publications of the American Acceptance Council.

financial centers on behalf of the former's customers. The interior bank, instead of issuing a letter of credit itself to an applicant customer, gets one of its metropolitan correspondents to issue a letter for the customer's account, and guarantees that, in case the customer fails to put the issuing bank in funds to meet the acceptances, it will do so. If no letter of credit is drawn, the metropolitan correspondent simply agreeing to accept a draft drawn on it by the customer, the interior bank, in a collateral agreement with the correspondent guarantees the customer's obligation to provide funds against maturity of the acceptance. The guarantor's liability is the same in either method of conducting the transaction. Some banks also, in consideration of a fee or commission, indorse acceptances for the accommodation of their customers or note-brokers.

No express authority of law authorizes a national bank to lend its credit by indorsing an acceptance or by guaranteeing or acting as surety on a letter of credit. Whether such activities are *ultra vires* or not for a national bank, has not yet been determined by the courts; it is, however, definitely determined that a national bank's power to discount negotiable paper and to loan money does not carry with it the power to guarantee, or act as surety upon, the obligation of another, nor is such power incidental to the business of banking. And it does not seem that the power to accept drafts and issue letters of credit incidental thereto carries with it the power to guarantee, or act as surety upon, acceptances or letters of credit issued by other banks.

To obviate these legal limitations the Federal Reserve Board has suggested that: (1) instead of guaranteeing acceptances, the bank purchase them outright and immediately resell them with its indorsement, since the power to indorse is incidental to the power to negotiate; and (2) instead of guaranteeing letters of credit issued by metropolitan correspondents, the metropolitan bank as agent of the interior bank issue a letter of credit for the account of the interior bank's customer, the letter to be issued in the name of the New York correspondent, but in issuing the letter the New York correspondent is to act as agent for an undisclosed principal, namely, the interior bank.

The Drawer

When bank commercial acceptance credits are issued they are made available either by the drafts which the taker himself intends to draw or by the drafts of a third party. For instance, a buyer of merchandise may take out a banker's credit and draw drafts on the issuing bank and remit to the foreign seller, who will hold the drafts till maturity or discount them in the market. Or an importer may take out a credit available for drafts of the foreign seller. If the foreign seller is satisfied with the credit title of the drawee bank, he may consider his own contingent liability as drawer negligible, and the first discounter may also regard his contingent liability as indorser as negligible. But if the credit title of the drawee is clouded, even in a small degree, or if he is not well known, the first discounter will consider the credit rating of the drawer and will protect himself by offering a lower price for the draft or by making other provisions.

> There is a proper field for the use of banker's acceptances by the drawer under credit taken by himself in cases such as the following:
>
> When an importer has arranged to bring in goods under conditions that require longer credit than the usual terms or than the seller would wish to extend or to draw for. Frequently in such cases the terms stipulate payment on presentation or "sight against documents," whereas some further time is required for the sale of the goods that will furnish the funds to pay for them. A bankers' acceptance credit may be used to finance the carrying of these imported goods during such an interval provided it was arranged for with the banker as a condition to engaging in the importation or the transaction which involved the importation.
>
> Or, where goods have been sold and exported and, instead of discounting the bills on foreign buyers, these bills are lodged with a banker for collection and application of proceeds to liquidate an

acceptance credit granted against the exports represented by the pledged bills and documents covering the exportation.

Or, where bills are drawn by a shipper against documents in either export or domestic shipments, delivered to the banker for forwarding and delivery against cash, the latter, when received, to be applied by the banker in payment of the acceptance credit.

Or, where there is a contract to export, to perform which goods must be manufactured or assembled, requiring use of credit before actual export can begin, or ocean or through bills of lading can be procured, but which the exporter has agreed to procure and deliver to the accepting banker.

Or, where goods have been sold or contracted for export but are delayed in transit to port or are at port awaiting bottoms.

Or, where staple commodities properly stored and insured are awaiting shipment or market or manufacture and are pledged to secure credit taken.

Or, if from some unforeseen cause or delay interfering with the prompt liquidation of the transaction a continuation of credit is required and an importer or exporter might properly wish to draw a new bill to retire one maturing.

All of these cases, and possibly others, would fall well within the spirit of the law and principles. All are confined to certain transactions involving importations, exportations, or domestic shipments, the proceeds of which will come into the banker's hands in due course to be applied in liquidation of credit, or are properly secured by pledge of staples.[5]

[5] Publications of the American Acceptance Council.

CHAPTER LXI

COMMERCIAL CREDIT DEPARTMENTS

Import Commercial Credit Department

In a bank doing a large foreign business under commercial credits the business of issuing the credits and handling the transactions under them divides itself naturally into the two divisions of imports and exports. The departments handling these divisions are commonly called "import commercial credit department" and "export commercial credit department," respectively.

The work of the import commercial credit department consists of the issuance of the letters of credit, the handling of the documents and drafts drawn under the letters, the collection of such items at maturity, and the incidental correspondence. The internal organization of the department will logically follow these subdivisions of the work.

The Issuance of Import Credits

When an application for a credit is received from a customer or from a bank for one of its customers, an offering slip is prepared stating the liabilities of the client in this line. In case of a guaranteed credit, the total liabilities of the guarantor, that is, all the credits that have been opened, even if they are for account of various parties, must be taken into consideration. The offering slip must show clearly the conditions under which the credit is opened, such as the tenor of the drafts, clean or documentary, whether documents are to be delivered against payment or trust receipt, or whether the merchandise is to be stored and insured in the bank's name and the documents turned over to it. These slips are passed upon first by the officers of the foreign division and by the officer in charge of the bank's interests in the federal reserve district where the client is located and later at the officers' meeting.

Under a ruling of the Comptroller of the Currency, one national bank cannot guarantee to another bank the obligations of its customers. When, therefore, the bank receives an application for a commercial credit from a national bank for one of its clients, the bank fills out a special form of application and the importer signs a separate special form of obligation.

The customer's agreement, with a copy of the credit annexed, is next filled out. The credits opened by mail are then typewritten from these agreements, credits opened by cable requiring no written instruments, as the correspondent or branch notifies the beneficiary of the conditions of the credit. Original and duplicate instruments are delivered with the agreement to the party for whose account the credit is opened, or to the guarantor if it is a guaranteed credit, unless the bank is instructed to deliver the original to a specified party or to forward it to the beneficiary.

Upon return of the agreements the signatures are verified. After this verification the receipt of every guaranty is acknowledged and accepted, in order to make it binding.

As a rule the bank does not insert the details of the sale in the credit instrument, as the shipment, price, quality, and quantity are matters of contract between vendor and buyer and cannot be controlled by the letter of credit. The letter of credit covers the financial part of the transaction in a general way, and neither the bank nor its correspondents can be held responsible for any particular arrangements. The findings of the Federal Reserve Board on this point are as follows:

> Credit letters ordinarily do not allude to the sales contract between buyer and seller, for the issuing bank has no direct concern in terms of this document or in any controversies which may arise over the merchandise. Moreover, the banker negotiating the drafts under the letter would look with disfavor upon the inclusion of commercial details which he is unable to verify. In

> fact, a credit, burdened with such stipulations, would prove of little value, as foreign banks generally refuse to negotiate the drafts. On the other hand, some banks feel obliged to protect the interests of their clients, and this explains the considerable number of institutions reporting that they do refer to the sales contract in their letters of credit. Such mention is made to a varying degree. In some cases the terms of the credit merely follow the stipulations of the contract in a general way. Other banks go to the extent of specifying the grade, quantity, and price of the merchandise. One bank protects itself by requesting "a declaration, furnished by the accredited party, that the goods were shipped in accordance with the terms of the contract between the buyer and seller."[1]

The following records would be kept of the credit issued:

1. A numerical entry in a daily record of credits issued.
2. A credit card, on which all details pertaining to the new credit are given.
3. A customer's card, which shows the total liabilities of each customer and is filed alphabetically.
4. A beneficiary's card, which shows the number of the credit and is filed alphabetically.
5. A guarantor's card, which shows the number and amount of guaranty and is filed alphabetically according to city.

The amount of each new credit is charged in a memorandum to a Commercial Credits Issued account, which constitutes the bank's contingent liability in this respect. Credits paid for in advance would not be charged to Commercial Credits Issued account, but would be credited to the correspondent's account or to some such account as Sundries—Commercial Credits. If payment is made in advance no agreement is required with the customer.

According to the terms of the credit, insurance is effected either by the foreign shippers or by the client in America. If

[1] Federal Reserve Bulletin, Feb., 1921, p. 166.

insurance is effected by the American client, the bank ascertains the name and address of the insurance company and advises it of the issuance of the credit, stating the number, the amount, the beneficiary, the party for whose account the credit is opened, and that the bank understands that shipments made under this credit are to be insured under a policy of the company; therefore the company is requested to take note of the bank's interest, as loss, if any, should be made payable to the bank.

A credit may be increased or its duration extended or certain of its conditions changed at the request of the client. In such cases the bank requires an additional guaranty.

The term of the letter of credit is fixed in the instrument in various ways. The naming of a specific expiration date or saying that the credit is "available until" or "becomes void if not used on or before" a certain date, invites dispute whether the credit expires at the office of the negotiating or of the credit-issuing bank. To provide that drafts drawn under the letter of credit must be "drawn prior to" a named date protects the issuer less than to require that they be "negotiated prior to" that date, for the beneficiary may postdate his drafts. The date of expiration may be set by stating the latest date at which: (1) drafts may be presented, (2) shipments may be completed and drafts drawn (or negotiated), or (3) bills of lading may be dated and drafts drawn. The most common method is to fix the latest date for drawing drafts and completing shipments.

The two basic principles of a letter of credit are, first, authorization to draw drafts, and, second, a general promise to honor such drafts. The authority to draw is variously phrased, but all statements are practically equivalent to the simple words "we hereby authorize you to draw on" a named bank.

Forms of the Application and Letter

The taker of the credit makes an application in somewhat the following form (Figure 40):

APPLICATION FOR COMMERCIAL LETTER OF CREDIT

New York, ... 19..

The ....of New York
New York

Dear Sirs:

We beg to request you to issue a Documentary Letter of Credit in any of your usual forms as follows:

Amount.....................
Favor of..
Account of..
Available by drafts at..
Covering Invoice value of.....................................
Shipment to..................and to be effected within............
Duration of the Credit to be limited to...........................
Documents required..
Insurance to be effected by.....................................
Credit to be opened by mail—cable...............................

The Letter of Credit is to be subject to your usual terms and conditions; and we agree to pay you the amount of each acceptance under it in cash at or prior to the maturity of such acceptance, at any time you may request it, and we hereby authorize you to charge our account with you with any and all amounts that may, at any time or times, be due from us to you hereunder.

Neither you nor your correspondents shall be responsible for any loss arising from any difference in quality or character of merchandise imported under this credit from that stipulated and expressed in the invoice accompanying the drafts, nor for correctness or genuineness of documents, nor for delay or deviation from instructions in regard to shipment.

Your charge for commission under such credit shall be ...... per cent for such part as shall be used.

You are further authorized to surrender to ....
or their nominees, from time to time, any merchandise shipped under this Credit, or the bills of lading therefor, under your usual form of trust receipt, signed by...

This Letter of Credit can only be withdrawn or cancelled with the consent of all parties interested.

Yours very truly,

....
(Signature of Applicant Bank)

Figure 40. Application for Commercial Letter of Credit

The letter of credit issued, say, in sterling would read somewhat as follows (Figure 41):

THE .... BANK OF NEW YORK

Letter of Credit No............

New York, ... 19..

....

....

....

Gentlemen:

We hereby authorize you to value on the

....

for account of...

up to an aggregate amount of...................................

....

available by your drafts at....................................

against Bills of Lading for....................................

....

....

Bills of Lading for such shipment must be made out to the order of The .... Bank of New York and, together with Invoice, must accompany drafts.

A Duplicate of such Invoice, with Consular Certificate attached, together with one copy of Bill of Lading, must be sent by the Bank or Banker negotiating draft direct to The .... of New York, New York, by mail, attaching to the draft a statement to that effect.

Insurance...

Any draft drawn under this credit must state that it is "drawn under Letter of Credit, ... Bank, No. .... dated New York,...,"

and must be advised to the.......................................

We hereby agree with bona fide holders that all drafts issued by virtue of this Credit and in accordance with the above stipulated terms, shall meet with due honor upon presentation at the office of the............ .... if drawn and negotiated...................................

Yours respectfully,

....

Figure 41. Commercial Letter of Credit

The annexed agreement with the importer would read somewhat as follows (Figure 42):

THE .... BANK OF NEW YORK,

New York City

Dear Sirs:

In consideration of your issuing your Letter of Credit No........... as per annexed copy we hereby agree to its terms and bind ourselves to furnish you, at any time you may request, but not later than 12 days before maturity of the acceptance under it, with first-class approved bankers' demand bills of exchange, for the same amount, payable in London and bearing our indorsement, or to pay the equivalent thereof in cash at the current rate of exchange for first-class bankers' bills; and we hereby give you a specific claim and lien on all goods and the proceeds thereof for which you may come under any engagements under said credit, on all policies of insurance on such goods, and on all bills of lading given therefor, with full power and authority to take possession and dispose of the same at discretion, such claim and lien to cover also all charges for expenses and commissions. We hereby authorize you to charge our account with you with any and all amounts that may, at any time or times, be owing from us hereunder.

Neither you nor your correspondents in London shall be responsible for any loss arising from any difference in quality or character of merchandise imported under this credit from that stipulated and expressed in the invoice accompanying the drafts, nor for correctness or genuineness of documents, nor for delay from instructions in regard to shipment.

Your charge for commission under such credit shall be..........per cent for such part as shall be used.

Merchandise imported under this credit shall be paid for, or approved security lodged with you, in your discretion, before surrender of the documents. All securities which shall be received by you hereunder may be held and applied by you also to secure all other indebtedness or liability existing, or which may hereafter arise, from us to you.

All goods imported by us under this or any other credit issued by you, or their proceeds, whether the draft against the same shall have been paid or not, or whether the goods shall have been delivered to us or not, may be held by you as general collateral security for any and all indebtedness to you, arising at any time or times from credit extended to us, or from any and all letters of credit issued by you, under which we may be entitled to import goods.

You are also authorized to surrender to us or our nominees, from time to time, any merchandise shipped under this credit, or the bills of lading therefor, under your usual form of trust receipt signed by us.

This letter of credit can only be withdrawn or cancelled with the consent of all parties interested.

....

(Signature of Importer)

Figure 42. Agreement Annexed to Commercial Letter of Credit

The agreement annexed to the dollar credit is almost the same in wording as that annexed to the sterling credit, except that the clause, "we hereby agree to its terms and bind ourselves to pay the amount of each acceptance under it to you, in cash, at least one day prior to the maturity of such acceptance, at any time you may request it," is substituted for the clause, "we hereby agree to its terms and bind ourselves to furnish you, at any time you may request, but not later than 12 days before the maturity of the acceptance under it, with first-class approved bankers' demand bills of exchange, for the same amount, payable in London and bearing our indorsement, or to pay the equivalent thereof in cash at the current rate of exchange for first-class bankers' bills."

Handling of Documents

Taking a sterling credit as an example, when the foreign exporter has the goods ready for shipment he draws, say, a 4 months' sight draft for the amount of the shipment or part of it, according to the arrangement with the bank under the terms and conditions of the credit. The margin varies with the nature of the merchandise and other factors. The exporter then takes this draft with the documents to his banker and sells it at the prevailing rates for 4 months' sight drafts on London. The bank negotiating the draft, or sometimes the exporter himself, will send one set of documents to the New York bank. The draft with the remaining documents and a statement that one set of documents has been sent direct to the New York bank is forwarded to an agent in London, who presents the draft to the drawee London bank for acceptance. In accepting the draft the London bank detaches the documents and mails them to the New York bank, advising the amount of the draft and the date of maturity.

The shipping papers when received by the import commercial credit department are entered in its records and indorsed over to the importer or guarantor, as the case may be. With the documents the department sends a schedule giving details as to the amount of the draft, both the London and the New York maturity dates, specification of the documents, the name of the steamer, and the nature of the merchandise; it also sends a trust receipt to be signed and returned to it. If the credit is guaranteed by a third party, the department may not insist upon the return of the trust receipt.

A trust receipt is a form of receipt for merchandise according to the terms of which the customers agree to hold the merchandise for the bank's account as agents, under stipulated conditions. By virtue of this trust receipt, title in the merchandise remains with the bank until the draft is paid by the importer.

A trust receipt (Figure 43) reads as follows:

New York, March 2, 1921

RECEIVED from the .... Bank of New York, the merchandise specified in the Bill of Lading per S.S. "EMPRESS OF INDIA," shipped under Letter of Credit #1,000, fifteen bales Raw Silk, which we hereby agree to hold in trust for the account and benefit of said Bank, as its agents, with power to sell the same, and in case of sale to pay over to it forthwith the proceeds thereof as security for any sums due or to become due under the said Letter of Credit, and also as security for any indebtedness from us to the said Bank.

The delivery of said merchandise shall not operate as a waiver of the ownership thereof, and the said Bank may, by its representative, at any time enter any place where the said merchandise is stored and resume possession thereof.

Until the sale of the said merchandise, we agree to keep the same insured at our own expense, against loss by fire, in the name of said Bank, and to deliver the policies of insurance to it.

£1,000—/—Stg.
Due London, June 20, 1921. (Signed) ....
" New York, June 8, 1921.

Figure 43. Trust Receipt for Goods Shipped Under Commercial Letter of Credit

Most banks will release goods on trust receipt signed by the importer for the purpose of delivering them to a bona fide purchaser. A few banks decline to relinquish the merchandise for manufacture by the importer himself, because of the difficulty in identifying the materials once they have been transformed into finished goods.

Goods frequently arrive before the shipping documents which for some reason have been delayed. In this event banks usually release the merchandise to prevent it from going into general order, which would give rise to a charge for warehousing goods not immediately claimed. Also, when goods are perishable, it is advisable to facilitate their sale. The importer is compelled to give customs and steamship officials a bond of indemnity before they will permit him to remove the goods without producing the documents. The bank protects its interest in the goods by securing from its client a trust receipt and also a statement that he will not reject the shipment even if irregular. A bank may further insist upon having the goods consigned to its order. In general, banks grant this concession only to customers of good standing.[2]

Documents received in the mail or handed over the counter with dollar drafts attached are handled in the same manner as those against which foreign correspondents have accepted drafts in foreign currency for the bank's account. Should, however, any drafts be received and the accompanying documents be incomplete, for instance, if the consular invoice be missing, the draft is not accepted or paid for until authority is received from the client to do so. When he declines to authorize the bank to take up a draft with incomplete documents, it is entered in a book for turned-down items with the necessary particulars, such as the amount of the draft, name of the presenting party, credit number, reason for refusal to honor the item, etc. Such items cannot be protested by the presenting bank until twenty-four hours after presentation, according to the Negotiable Instruments Law.

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[2] Federal Reserve Bulletin, Feb. 1921, p. 167.

Handling the Bills of Exchange

All acceptances, whether foreign or domestic, are noted on the customer's card opposite the respective credit, under drawings, with the New York due date. They are also entered in ticklers according to the date of maturity. Dollar acceptances are entered in an acceptance book and numbered and stamped with the bank's acceptance stamp. The number of the credit and the nature of the merchandise are also indicated on the acceptance. Drafts drawn in United States gold are changed to United States currency, before acceptance. All long drafts received in the mail are tendered to the foreign collection department after acceptance to be disposed of according to instructions from the negotiating bank.

When seconds of exchange are received or presented before the first arrive, such seconds are accepted, provided they are in order and are accompanied by the necessary documents. The amounts of such drafts are entered in the list of seconds of exchange accepted and on the customer's card, say, in red ink, as a safeguard against acceptance also of the firsts of exchange. Such firsts of exchange, if received later, are stamped "second of exchange accepted." When seconds of exchange are received after the firsts have been accepted, they are stamped "original accepted."

Several summarizing lists are prepared in the department:

1. Every morning a list of commercial letters of credit issued the previous day and a list of all dollar drafts accepted the previous day are prepared and each day's transactions from Monday till Saturday are added. The lists are for use at the directors' weekly meeting.

2. About the 10th of each month a list of foreign acceptances and another of dollar acceptances are prepared, and copies are given to the bookkeepers to be checked with the book entries. These lists are marked from time to time with the date on which the bills are to be delivered or mailed to the customers.

3. A list showing the daily requirements of the following month is prepared, copies of which are sent to the traders and to the clerk in charge of the position sheets in order that cover may be provided when due.

Preparation of the Tickets

As explained above, the amount of each new credit issued is charged in a memorandum book to the Commercial Credits Issued account, which constitutes a contingent liability for the bank. Credits paid in advance, however, are not so charged but are credited to the correspondent's account or to the account Sundries—Commercial Credits. This is the procedure in all straight credits, but some variations are introduced in handling the less common types of credits.

When acceptances are made under letters of credit tickler slips are prepared, containing the maturity dates and details for entry in the ticklers. The tickler slip for an acceptance under a foreign currency credit would have the following data: the date of the ticket charging Customers' Liability account, the commercial credit number, for whose account, the dollar amount, the commission per cent, the New York maturity date, the foreign maturity date, by whom accepted, and their commission per cent. The tickler slip for an acceptance under a dollar credit would have the same data, except that contained in the last three entries, and would also have the acceptance number affixed to the draft at the time of accepting.

When notice is received of an acceptance made by correspondents under letters of credit in foreign currency, tickets are prepared (Figure 44) charging Customers' Liability: Acceptances of Foreign Banks under Commercial Credits, and crediting Acceptances of Foreign Banks under Commercial Credits (the Correspondent Bank). The tickets covering the bank's actual liability (as contrasted with the contingent liability arising when the letter of credit was issued) are made out in the following manner:

No	No ....
The ...... Bank of New York	The ...... Bank of New York
New York,........	New York,........
Charge: Customers' Liability: Acceptances of Foreign Banks under Commercial Credits.	Credit: Acceptances of Foreign Banks under Commercial Credits (the correspondent bank).
Commercial Credit No.... Due.......	Commercial Credit No.... Due.......
Pounds sterling...... @ 4.85 $.......	Pounds sterling...... @ 4.85 $.......
Francs............... 5.20	Francs............... 5.20 ....
Lire................. 5.20	Lire................. 5.20 ....
Marks.............. .95	Marks.............. .95 ....
Cashier.............	Cashier.............

Figure 44. Bank's Liability Ticket for Acceptances Under Commercial Letters of Credit in Foreign Currency

Since the war the conversion rates have, of course, been very much lower than those given above and the method of quotation has been changed to cents per franc, lira, or mark. When the above tickets go through the bookkeeping department the amount of each draft is credited to Commercial Credits Issued, Foreign Currency, thereby reducing the bank's contingent liability as its actual liability is increased by accepting drafts under the credits.

When a draft is accepted under a dollar credit issued by the bank, tickets are prepared charging Customers' Liability: Acceptances of This Bank under Commercial Credits, Foreign, Import, and crediting Acceptances of This Bank under Commercial Credits, Foreign. The last account constitutes the bank's actual liability under dollar credits. The tickets (Figure 45) are drawn up in the following form:

The ...... Bank of New York No....	No.... The ...... Bank of New York
New York, Date...............	New York, Date...........
Charge: Customers' Liability: Acceptances of This Bank under Commercial Credits, Foreign, Import.	Credit: Acceptances of This Bank under Commercial Credits, Foreign.
Commercial Credit No..... Due......	Commercial Credit No..... Due......
$...............	$...............
Cashier..............	Cashier.............

Figure 45. Bank's Liability Ticket for Acceptances Under Dollar Credits

As the above tickets go through, the amount of drafts accepted is credited to Commercial Credits Issued, United States Currency, thereby reducing the bank's contingent liability under dollar credits as its actual liability increases through drafts accepted.

When a draft issued in foreign currency matures in New York, a bill is sent to the customer for its amount, converted at the prevailing check-selling rate on London, Paris, or elsewhere, as the case may be, plus the bank's commission. The New York maturity date is about two days prior to the foreign maturity date. About twelve days prior to the foreign maturity date, the bill is sent to the customer for the amount of the draft converted at the check rate. The bank allows a certain return commission to the guarantors for guaranteeing the performance of the obligation. If the importer maintains an account with the bank, that account is charged, unless there are other instructions; if not, remittance must be made in New York funds.

Bills covering dollar acceptances are mailed or delivered a few days before maturity and are payable one day before maturity. This is done in order to insure prompt receipt of funds; otherwise the department must carry such items in an account Advanced to Customers, Foreign Shipments, when they are presented for payment.

On the date of maturity of a foreign currency acceptance, the bank's foreign correspondent charges its account with the acceptance, and this wipes out the liability. The department then prepares a double ticket, charging Acceptances of Foreign Banks under Commercial Credits, and crediting Customers' Liability: Acceptances of Foreign Banks under Commercial Credits. Likewise, on the maturity date of a dollar acceptance, it is paid by crediting the holder's account, if there is such an account at the bank, or by issuing a cashier's check and crediting Cashier's Check account. The department then puts through a double ticket, charging Acceptances of This Bank under Commercial

Credits, Foreign, and crediting Customers' Liability: Acceptances of This Bank under Commercial Credits, Foreign, Import.

In case drafts are drawn for only a part of the credit, the unused balance still shows in the Commercial Credits Issued account and is not booked out until a reasonable time has elapsed after the fixed date when the credit expires. This delay is to allow documents to reach the bank which may have been negotiated prior to the expiration of the credit.

Drafts or payments under revolving credits are not credited to Commercial Credits Issued account until after the date of expiration of the credit, when the full amount of the credit is taken out.

If an importer prefers to anticipate payment of a draft accepted under a credit, interest is rebated to him, on the amount of the draft, from the date of payment until the New York maturity date. If the acceptance is under sterling credit the department credits its regular London account with the amount of the draft, and thereby reduces its stock of sterling exchange; but at the same time it credits Customers' Liability account and charges Acceptances of Foreign Banks under Commercial Credits. The London correspondent is asked to make entries in conformity with the department's tickets. Twelve days before maturity the department charges the Anticipated Payments of Acceptances under Commercial Letters of Credit and credits its special acceptance account with the London bank, and the London bank is asked to make conforming entries.

The Export Commercial Credit Department

This department handles the issuance of commercial letters of credit used in the export business and the documents and drafts drawn under the credits. In its operations and functions it is very similar to the import commercial credit department described above. Its organization also follows the same plan. The making of payments against documents, etc., constitutes a larger part of the operations of the export than of the import commercial credit department. It is understood, of course, that in the description below only the more typical operations are treated.

Method of Handling Exportation Under Letters of Credit

The methods of handling exports under letters of credit differ, depending upon the consignee country, the commodity, the terms of sale, and other factors. It will suffice to describe the procedure of financing exportations through dollar credits and acceptances.

The American exporter who has sold goods, say, to an English importer arranges through his local bank for such credit; accordingly the local bank requests its American bank correspondent to open a credit in favor of the American exporter, available by his drafts drawn, say, for 60 days' sight on the American bank and accompanied by certain specified shipping documents.

The American exporter then prepares his shipment, secures the bill of lading and other required documents, draws a draft against the designated American bank, and presents the draft to the bank for acceptance, together with the needed documents. The bank accepts the draft and thus fixes the maturity date 60 days hence; it separates the documents from the acceptance, returns the acceptance to the exporter, and forwards the documents to the foreign bank or other party designated by that bank.

The foreign bank delivers the documents to the English importer against such security as it deems fit. It is understood and agreed that the English bank will provide the American bank with funds to meet the acceptance before its maturity.

In the meantime the American exporter either discounts his dollar bank acceptance with his own bank or sells it in the open market at the prevailing rate of discount and thus realizes money for his goods.

The American exporter might have demanded from the English importer a sight credit instead of an acceptance credit. Under the sight credit he would receive cash against documents instead of the acceptance. What he would realize, of course, from the acceptance would depend upon the market, whereas the sum realized under the cash credit would be more definite and constant.

Issuance of Credits

Requests for the issuance of export credits are received from abroad by letter or cable, and credits are advised in like manner. The work is naturally divided between a letter clerk and a cable clerk. Letters received by the letter clerk and requesting the issue of a credit are sent to the foreign bookkeepers to have the signatures verified and to have the balance of the account of the bank or firm requesting the credit noted thereon. After the credit has been referred to an officer for approval, the letter is given a number and this number is stamped upon the card record kept of credits and also on the folder of correspondence appertaining thereto. An advice of credit is then prepared in triplicate, the original for despatch to the beneficiary, one carbon for the foreign division files, and one for the department files. The advice is checked against the letter of instructions. If the approximate amount of the payment is not known, it is necessary for the letter clerk to write or telephone the beneficiary to learn his requirements. These funds may then be segregated in a special commercial credit account which bears interest at the same rate as the regular account of the correspondent; the interest on the segregated funds accrues to the regular account, so that there is no accumulation in the amount set aside. The majority of American banks on opening a confirmed letter of credit in favor of an exporter do not set aside any actual funds, since they regard it as a credit rather than a cash transaction. Nevertheless quite a number of banks consider their confirmed letter of credit as an acknowledgment that funds are held for the use of the beneficiary in the sense that they are obligated to meet his drafts.

The cable clerk handles incoming cables that pertain to the opening of new credits or to the amending or canceling of credits already established. The cable clerk ascertains the balance of the bank or firm requesting a credit and, in case of a confirmed credit, the amount of the bank's present contingent liability for account of the party in question. The credit is then referred to an officer for approval. It is customary to despatch a letter of advice giving the details of the credit and a telegraphic advice containing the gist of the credit, the cost of the telegram being charged to the foreign correspondent. A memorandum is kept of all charges incurred for cables sent, and the debtor concerns are billed and followed up until the charges are collected.

It is an almost universal practice in international banking where instructions of any nature are cabled, to follow them up with a confirmatory letter which may be simply a copy of the cable, or a letter explaining in somewhat more detail what is desired. When such confirmations are received by the department, the confirmation clerk ascertains whether the original advice has been received or whether it has been delayed in transit, and whether its instructions have been properly executed. Whenever the confirmation contains further details than those contained in the cable or requires some alteration of the original instructions, the clerk makes the proper notations on the card record and advises the beneficiary accordingly.

The Departmental Records

The department bookkeeper keeps the contingent liability ledger, which contains a record of each credit opened, the details, the date of advice, whether by letter or cable, the number given by the foreign correspondent to the transaction, our number, the name of the party for whose account the foreign correspondent is handling the transaction, the name of the beneficiary of the credit, the merchandise, and the amount, entered either in the confirmed or unconfirmed column as the case may be. This ledger is indexed first under the name of the country, then under the name of the city, and lastly under the name of the individual or bank. It shows, therefore, the foreign exchange position with respect to any correspondent at any time and is an index of the activities of the account.

When a new credit is opened, entry is made in the ledger; when payments are made, the amount is written off the credit. The ledger is balanced, say, weekly, and proved with the foreign bookkeepers. Acceptances are similarly balanced. The department bookkeeper keeps a tickler showing the approaching necessity of making periodic payments under clean credits, and sees that the payments are effected on the dates stipulated. He also records the advances to customers on export bills. This amount is balanced, say, weekly and proved with the foreign bookkeepers.

The number of the credit is indexed alphabetically under the name of the beneficiary; a similar index is made under the name of the consignee for whose account the credit is opened. Another record is kept of the expiration date of the credits.

Probably the most useful record kept in the department is the card record of each commercial credit, containing all the original data, all subsequent amendments, instructions, and other data which concern any action that the department may be asked to take. These cards are filed alphabetically under the names of the beneficiaries.

The folder files are arranged numerically according to the number assigned to the credit at the time of issue. The folders contain all correspondence and other data bearing upon the credit and each piece is stamped with the credit number.

Acceptances Under Export Credits

When drafts are presented for acceptance, they are inspected and compared with the terms of the credit, and if found to be in proper form are numbered and recorded in the acceptance book against the corresponding numbers. The draft is then stamped across its face "Accepted," with the date, name of the bank, and signature of the officer. If documents accompany the draft they are sent abroad or retained as their nature requires. The date of the draft's maturity is calculated, and entered in the acceptance tickler, and the transaction is recorded in the liability ledger under the name of the party to be charged. If the holder of the draft desires that it be discounted, the bank discounts it either through its own domestic discount department or through an affiliated institution.

When the department accepts a draft under a credit, it charges some such account as Customers' Liability: Acceptances of .... Bank of New York under Commercial Credit, Foreign (or Domestic, as the case may be), and simultaneously credits an account Acceptances of .... Bank of New York, under Commercial Credit, Foreign (or Domestic, as the case may be). At maturity the debit and credit are reversed, and the party for whose account the draft was accepted is charged-the face amount. The commission may be billed either at the time of accepting or at maturity, depending upon the arrangements made.

Payments Against Documents

Drafts and documents are received by the department through the window, by mail, and from other departments of the bank. To concentrate responsibility within the department it is expedient to charge the window man with all receipts from every source and with the responsibility of ascertaining specifically the source and the party to whom credit is to be given for payment made. The window man is also responsible for the initial examination of the documents to see that they are in order regarding the most obvious matters, such as indorsement of bills of lading, etc.

It is the duty of the payment clerks to examine with care the documents or drafts received, to ascertain whether payment may be made, and if so, to attach the necessary tickets, and if not, to make up a statement of the reasons for refusal to pay. This work is very detailed and various. The payment men are responsible for the discovery of every irregularity in the documents or transaction, and all such irregularities are referred through the department head to the bank officer who is vested with authority to decide the course to be adopted in each case.

The examination conducted by the payment men is made for the following purposes:

1. To compare the documents, the credit card, and the accompanying letter, and determine to which credit the documents relate.

2. To determine whether the credit has been exhausted or canceled, and whether its expiration date has been passed.

3. To note the gist of the credit and see whether under the terms of the credit the proposed transaction is proper.

4. To check the invoice against the credit and see that both describe the same merchandise and that the invoice, bill of lading, and credit describe the merchandise in the same manner. This check includes price, quantity, units, etc.

5. To determine whether the marine insurance certificate covers the total amount of the debit which the bank is called upon to make. The commercial practice is to include an amount of 10 per cent in excess of the total payment. The vessel's name must agree with that mentioned in the bills of lading; and the mark numbers and the description of the merchandise must agree with the entries in the invoice and bill of lading. The certificates must be negotiable in form. When there are both original and duplicate certificates, as is usually the case, the bank must have both.

6. When a bank or individual for whose account a credit has been opened simply instructs the department to obtain shipping

documents, it is understood by the department that it is required to obtain order bills of lading, issued in full set, indorsed in blank. These bills of lading must be carefully signed by the steamship company or an authorized agent or by the master of the vessel, and must plainly designate the number of copies that have been issued, be dated, and issued to the shipper's order and for him, and indorsed in blank. They must be clean bills of lading, that is, they must bear no qualifying marks such as "bags torn," "not responsible for leakage," or any other phrases which shipowners are fond of using. They must agree with the invoice as to all marks and numbers and description of merchandise and must show the name of the steamer, its destination, and its route. Any erasures or corrections must be initialed by the signer.

If it is determined that the documents must be returned to the beneficiary for correction, notation of the fact that the documents were presented and payment was declined is made on the credit card and a memorandum of the exact nature of the irregularity is made and kept.

If, on the other hand, in the judgment of the payment clerk the documents are in order, he then records on the back of the credit card the date, the amount paid, the marks on the shipment, the description of the merchandise, the steamer's name and destination, and the character of the documents. Any discrepancies which are noted but passed are initialed by the person who approved them. If previous payments have been made, a pencil footing is carried down to show the total of payments. If the payment exhausts either the dollar amount or the merchandise amount of the credit, it is important that it be stamped "Exhausted and canceled" and delivered to the bookkeeper to be canceled on his records. If funds have been segregated and there is any balance left in the segregated account, the balance is restored at once to the regular account, together with the accrued interest. If there is a small merchandise or dollar balance left under the credit but of such nature that it seems improbable that it will be used, inquiry is made of the beneficiary about its disposition.

After the documents are sorted into original and duplicate sets, the debit advice and bookkeeping tickets are prepared and despatched. If payment is made against ocean documents, they are forwarded to the bank's foreign correspondent or the person designated by him, the debit advice being enclosed. If payment is made against railroad bills of lading, they are, in the absence of any other instructions, returned to the beneficiary of the credit, against trust receipt, by which he engages himself to return to the department in exchange at the earliest possible moment, ocean bills of lading. In some cases the department is authorized to pay against railroad bills of lading themselves, and then the trust receipt does not provide for return of the ocean bills of lading.

Payments Against Warehouse Receipts

Payments against warehouse receipts have certain peculiarities worthy of notice. The warehouse receipt is submitted to the proper bank officer for approval. In case the warehouse is not known to the department an investigation is made by the credit department, and upon its findings the officer acts.

Except in the few cases where the department is satisfied to accept the statement of the beneficiary of the credit that the goods are covered under his open policy, the production of the insurance policy covering the merchandise in question is necessary before payment. The payment clerk determines whether the description of the merchandise on the warehouse receipt and the invoice as well as the description of the location, agrees with that in the policy. To determine whether the policy covers adequately the interest of the bank and its correspondent in the merchandise, the payment clerk may employ an insurance expert. This expert may be a specialized clerk of the department.

As a general thing, policies should be opened in favor of the beneficiaries and of the bank, as their interests dictate. They should provide that if any losses occur they should be adjusted with and payable to the bank. They should bear the trust commission clause to cover the merchandise through all stages of the transaction and thus avoid the necessity of being signed. The insurance should properly provide cover for 10 per cent above the invoice value, and in the case of fire insurance should contain the 80 per cent co-insurance clause. A complete description of the quality and quantity of the merchandise widens the covering and is desirable. In case the bank does not appear as the assured, the assignment of the policy with the indorsement of the insurance company is necessary.

After payment has been effected against warehouse receipt, records are made of the name of the beneficiary and number of the credit, the name of the warehouse, the number of the warehouse receipt, description of the merchandise, the number of the units stored, the amount of payments made, and the date when the insurance covering the respective commodity expires. A letter is immediately despatched to the warehouseman advising him of the interest of the bank in the merchandise, requesting him to make no deliveries without proper order from the bank, inquiring as to the condition of the goods stored, and requesting him when rendering bills for storage to send them in triplicate and bearing the bank's credit number which is furnished.

When the insurance expires it is renewed. A special card record of insurance is kept to indicate the amount of the policy, the nature of the risk (fire, war, explosion, water damage, sprinkler, burglar, etc.), the expiration date, the commodity insured, the beneficiary of the credit, and the name of the broker with whom the insurance order is placed. The dates when the broker placed the insurance and when the policy was received are also entered on the card. The cards are filed on the basis of expiration dates.

Sprinkler insurance is generally ordered in an amount equal to 20 per cent of the invoice value of the merchandise. Burglary, theft, and larceny insurance, when required by the terms of the credit or by general instructions from the correspondent, depends for its amount upon the nature of the commodity. If the bank has no specific instructions in this matter, it is guided somewhat by the advice of the beneficiary or the insurance broker as to the general custom.

Before bills representing storage charges and insurance premiums are paid, the items are checked against warehouse receipts to see that they refer to the proper merchandise and against the insurance card to see that the proper rate is charged and that the computation is correct.

Merchandise held by the bank in warehouse is delivered for the purpose of shipment or resale. When opening a credit payable against warehouse receipt, the correspondent may give instructions as to the disposition of the warehoused merchandise; but if no such instructions are received, the bank despatches a letter requesting instructions and stating that unless instructions to the contrary are received meanwhile, it will upon request deliver the warehouse receipt to the beneficiary of the credit, when informed by him that he has arranged for forwarding and desires to effect shipment and secure ocean bills of lading. The letter also asks whether the bank is to pay the forwarding charges when ocean shipment is effected.

When the bank has specific instructions the delivery is simple. The warehouse receipt is delivered to the designated person against his receipt, or trust receipt, and an obligation to return to the department the ocean bills of lading. If the bank is authorized to pay the shipping charges he is so informed. The bank requests prompt advice of removal of the goods from the warehouse, so that it can cancel the insurance and receive a refund of the unearned premium.

If the goods are to be resold, the bank follows the instructions given it. These are of great variety. The commission for effecting resales is generally greater than for effecting payments. For holding merchandise in warehouse, effecting the necessary payments for storage, insurance premiums, and keeping the goods covered, a flat charge is imposed per mille per term.

Advances Against Export Bills

Frequently a mercantile house which does most of its business upon a collection basis wishes to realize upon its collection items. To facilitate this operation an account is established from which advances are made to exporters against certain bills, or else the bank accepts drafts drawn against it. The acceptances bear a lower rate than the loans, but the bank's commission charge for accepting absorbs part of this difference. The bookkeeper who handles the account takes from the foreign collection department items sufficient to cover the draft or loan with a margin for safety; their amount is entered in the advances book, and the collection department's ticket is so stamped that the proceeds when received will not be paid to the exporter, but will be credited to the exporter to pay his loan, or cover his acceptance, at maturity. The interest is adjusted at maturity and the commission is collected either at the time of acceptance or maturity, as the arrangement may be.

CHAPTER LXII

MISCELLANEOUS DEPARTMENTS

Minor Departments

In this chapter will be briefly discussed the operations of various minor departments of the foreign division. It is not meant to imply that these departments, or any of them, are not important or that their work is not essential to the conduct of the bank. But an extended discussion of their operations is not given here for the reasons that analogous departments exist in the domestic division, of which, in Volumes III and IV, a full description has been given, and that either their work is relatively simple and can be stated briefly or their duties are too multifarious and technical to describe in detail. For instance, in Volume IV, Chapter XLVII, the work of the credit department of the domestic division is described in detail, and the foreign credit department is included as a division of that department. The nature of the foreign credit department can be understood from the description of the foreign trade department in Volume III, Chapter XXXVIII, and of the credit department in Volume IV. Its relation to the management of the foreign division is told in Volume V, Chapter LIII. Again, the work of such a department as the translators' department is so uniform and simple that few words are needed to describe it, whereas that of the legal department is so diverse and technical as to defeat or make undesirable much generalization.

The Nature of the Foreign Correspondence of a Bank

The handling of the incoming and outgoing foreign mail and cables is a responsible part of the work of the foreign division. Various factors complicate foreign correspondence, such as great distances, high cable charges, few carriers, national boundaries, different commercial and postal systems, the necessity for translations, risks of ocean transit, use of duplicates of letters and documents, etc. The foreign mail is more irregular than the domestic and comes and goes in batches as the vessels arrive and sail. The possibilities of error are more numerous and the costs of corrections and adjustments are greater than in domestic mail. Since the mail is in transit longer and mail schedules are less dependable, the figuring of interest on funds in transit is both an important and a difficult problem.

The work incident to the receipt and despatch of foreign communications is best handled in specialized departments in large banks and by specialized clerks in smaller banks. This concentration leads to expertness in handling and makes easier the placing of responsibility and the location of errors. The work naturally divides itself into the following routine matters which may be advantageously handled in separate departments:

1. The incoming mail
2. The outgoing mail
3. The registered mail
4. The translations
5. The cables

The Foreign Incoming Mail Department

The incoming foreign mail reaches the foreign incoming mail department in three ways: (1) the mail teller of the domestic division turns over unopened to the foreign division all mail which from the address or other markings he knows ought to go to it; (2) when there is any doubt whether mail should go to the foreign or the domestic division it is opened and sorted by the mail teller and sent from the sorting room to the foreign incoming mail department; (3) after all registered mail has been signed for by the note teller in the mail teller's department the foreign portion is sent to the foreign registered mail department, which is really a part of the larger incoming mail department.

All non-registered mail is sorted into racks according to the departments of the foreign division. Every item is then stamped with the date of receipt and a number. Specialized clerks are delegated to receive all the mail from certain territories, such as the South American, the West European, etc., and to make entry in a book of the numbers, dates, etc. This record makes it possible to know what mail has been received and to follow the item to see that the business is executed—an advantage that outweighs the delay occasioned by booking the items. After the mail is sorted, stamped, and recorded, it is distributed to the proper departments, and most of the clerks are then free to work in other departments for the rest of the day.

The work during the day consists of distributing the following irregular items:

1. Certain pieces that concern two or more departments must be delivered successively to each.
2. Missorted pieces that return for proper distribution.
3. Pieces not addressed to the bank but reaching it by error as an enclosure or through some other mistake.
4. All pieces ambiguous in address or contents which require to be sent on a departmental round robin or referred to the bank officers or returned to the remitters for enlightenment or instructions.

The Foreign Outgoing Mail Department

This department receives the outgoing foreign mail from the various departments, and sorts, packs, stamps, registers, insures, and despatches it. The mail comes to the department open and addressed and in duplicate or triplicate. The original (letter and documents) is sent by the first mail, the duplicate on some other steamer, and the triplicate goes to the files. The racks into which the mail is sorted are divided according to groups of countries, and the pigeonholes are arranged alphabetically by countries or cities and in double tier, one for the originals and one for the duplicates. The sorters separate the originals and duplicates and put them into their proper racks and pigeonholes. The packers put the mail into their proper envelopes, and stamp and seal them. All negotiable instruments, such as drafts, bills of lading, insurance certificates, consular invoices, etc., are sent by registered mail. The ordinary letters and advices are put in separate unregistered envelopes.

The numerous rules for handling the mail are the product of experience or of special instructions of the addressees or of postal regulations here and abroad. For instance, the rules for routing depend upon the steamers and the ports at which they call; the rules for registering may be changed at the request of a branch or correspondent; the post-office day in Mexico runs from 12: N. to 12: N., etc. The sailing list of mail steamers is prepared by the United States post-office, and copies of this are distributed to the interested departments and officers of the bank.

The detached copies are dated and sorted for the files into such lots as export items, dossier, signed letters, bookkeeper's copies, office copies, draft advices, letter payments, etc.

All letters placed in the mail bag are carefully checked for stamping, sealing, addressing, and marking, and a record is kept of them. The department prepares tickets monthly charging the postage to the proper accounts. Records are also kept of the stamps received from time to time on requisitions, and of those withdrawn and put into the current stamp box; and other records are kept of the stamps used each day, and of the number of pieces of mail.

Foreign Registered Mail

The registered mail usually contains valuable items such as stocks, bonds, coupons, etc., and on account of the responsibility of handling such items the work is conferred upon a separate department with very trustworthy employees.

The incoming registered mail is received from the note teller against receipt, and a record is kept of the following details: the United States registry number, the name and address of the correspondent, the foreign registry number, and the contents of the package. The number of packages and the number of entries are counted and proved against each other. All personal mail and envelopes containing letters of value are delivered intact to the proper departments against receipt. The securities are entered in a receipt book and are delivered to the customers' securities department against signature. The coupons are listed and totaled and delivered to the collection departments. Everything of value received is acknowledged by first mail on forms giving the registry number, date of advice, and description of contents.

A record is kept of the outgoing registered mail, giving the date of shipment, list of contents, numbers on coupons, date of last coupon, name of party on stock certificates, expiration date and rate of bonds, and name and address of consignee. Two employees sign a paper to the effect that they personally have seen contents of the package and know them to be as stated, and that the package was securely wrapped and sealed in their presence and never left their custody until receipted by the post-office. The insurance and postage charges are recorded and charged to the proper accounts.

Incoming Currency Shipments

The bill of lading for currency shipments coming from abroad is indorsed and forwarded to the bank's custom-house broker, with a statement of its value and instructions to have it examined at the bank or assay office. The broker has the shipping clerk or purser transfer title to the bank against receipt of documents or guaranty of ownership. To do this he pays the freight, gets a release, locates the steamer, and after inspection by the custom house inspector, has the freight delivered to the assay office against receipt. The receipt is returned to the bank for checking against the above statement. In case the bank has not received the shipping documents or part of them or they are not in order, the department issues to the custom house a guaranty of ownership. Receipt of the currency is acknowledged to the consignor, and he is later informed of the amount of the proceeds after charging his account for insurance, freight, commission, cartage, custom house brokerage, and incidental expenses. In case a shortage appears in a currency shipment, affidavits are drawn up reciting the contents as received and signed by two persons. On certain shipments the department looks after the insurance. Currency shipments are often in series, one after another, from the same consignor to the same consignee and for the same account. They are also sometimes made to two accounts and the charges have to be prorated according to the division of the shipment.

The Translators' Department

The translation of incoming letters from a foreign language into English and of the outgoing letters from English into the proper foreign language constitutes the work of the translators' department.

The incoming mail that requires translation is divided into three or more classes, and is taken up in the following order:

1. Specials, including letter payments, transfers, etc., requiring immediate attention.
2. Semispecials, including confirmations of cables of large amounts, advices, etc., requiring less prompt attention.
3. Reserve, such as acknowledgments, confirmations of small amounts, orders, circulars, etc., the translation of which may be postponed if necessary.

Copies of the originals and translations are made and carefully checked, after which one copy is filed and the others are sent to the proper departments.

A clerk in the department examines the outgoing letters and determines in what language they are to be answered, the determination often being based on the request of certain correspondents and customers abroad, particularly in small cities and towns. The translation of the outgoing mail is made in the latter part of the day and in the order of the foreign mail sailings.

The translators are, of course, required to possess an expert knowledge of the commercial language into and from which they are translating as well as of commercial English. The number of translators needed in the department depends upon their linguistic abilities, the volume of business done, and the number of countries with which transactions occur. The work is responsible, for errors in translating may prove costly.

The Cable Department

All cables and telegrams received and despatched by the foreign division are, respectively, decoded and coded in the cable department, which also handles the cable charges. The cables contain quotations of rates, orders to buy, sell, or deliver securities, or goods covered by collection items, orders for payments, requests for information, advices of payment or acceptance, difficulties that have arisen in connection with collection items, etc. The hours when the department is busiest coding and decoding messages are from 9 to 11, 12:30 to 1:30, and 3 to 5:30. The rest of the day is used in constructing and developing codes, registering cable addresses, incorporating new phrases in codes, checking cable bills, apportioning cable charges, and attending to correspondence. A large bank may possess from 50 to 75 codes, some of them of very ingenious character and all of them designed to save time and money and some of them to insure secrecy.

The incoming cables are translated from code into plain language by two persons independently. These messages are then compared and harmonized and the text is copied into a book. A color scheme may be used to distinguish the cables for the different departments and avoid confusion. If a cable contains instructions for several departments, as many copies are made as are required.

A similar twofold translation from English into code is made of outgoing cables, which are compared, harmonized, and recorded in a book. To protect itself in transferring money by cable, the bank adopts a system of control. In the preparation and despatch of messages both the cable clerk in the foreign tellers' department and the clerk in the cable department are required to use the original contract of instructions in coding the cable, and a careful comparison is made of their translations before the cable is despatched. A second control is the use of test words, or secret symbols, which are always added to important cables to establish their authenticity and thus guard against fraud. The test words are controlled by an officer, who will not communicate them to the cable clerk unless his figures agree with those of the cable department. A third and final check or control is made by the auditing department, which checks the original cable against the duplicate copy received from the cable company.

The clerk who handles the cable charges determines the proper amounts, apportions them, and enters them on debit and credit tickets furnished by the cable clerk of the foreign tellers' department. The clerk who handles the executed copies of the cables makes an entry of the charges to the different accounts in the customers cable ledger from the duplicates received from the cable companies.

Foreign Customers' Securities Department

The correspondence between the bank and its foreign customers regarding their securities is handled by the foreign customers' securities department, a division of the customers' securities department of the domestic division, to which department is entrusted the actual custody of the securities and the execution of purchases, sales, transfers, collection of coupons, dividends, and due bonds, etc. This line of cleavage is dictated by convenience and efficiency, as the segregation of special duties in a special department provides the best means of handling the work without a duplication of departments.

The departmental correspondence relates to:

1. The receipt and collection of coupons for foreign customers.
2. The receipt and credit of dividend checks on stocks owned by them.
3. The execution of purchases and sales for foreign customers in American markets.
4. The purchase and sale of securities abroad for clients.
5. Income tax requirements, the regulations of the Commissioner of Internal Revenue requiring this department to prepare and file a statement of all dividends and interest received for foreign accounts from securities held by the bank for safe-keeping.

The incoming mail may be divided into four classes:

1. Bond orders and inquiries.
2. Instructions to receive or deliver securities, orders for the purchase or sale of stocks, and instructions as to subscriptions to new issues.
3. Acknowledgments.
4. Confirmations of cablegrams.

The letters of the first two groups are entered in a blotter, are verified as to signatures, are initialed by an officer, and are then turned over to the bond department or the domestic customers' securities department. Later in the day these departments send back to the foreign customers' securities department written advices of the work done, the advices are checked against the blotter, counter bookkeeping entries, if any, are made, and letters are written to the foreign clients. The blotter has columns for the following data: the date when the order is received, the date of instructions, the amount of bonds or number of bond orders sold, the name of the security sold, the limit, the duration limit, the time limit, and remarks.

Some of the bank's foreign clients give the department dividend orders on the various companies in its favor. These orders are entered in a book kept for the purpose, showing the name of the stockholder, the account to be credited when the dividend is received, the date of the letter transmitting the power to receive dividends, and the date of the power. When by reason of these powers dividend checks are received, they are passed to the credit of the foreign client.

From time to time the department receives from foreign customers stocks of various companies for transfer to other names. Such stock is turned over to the domestic customers' securities department against receipt. When the instructions have been executed, the new certificates are handed to the foreign registered mail department, which makes a record of the shipment, takes out any insurance necessary, and mails the package. All such shipments are checked against the advice of the domestic customers' securities department and against the letter sent to the foreign client, a copy of which accompanies the securities. The original letter is despatched by regular mail.

A fee, fixed by agreement with each client and based either on the market or par value of the securities on hand or received, is charged for handling the securities, and a bill is rendered, say, semiannually. During the month preceding the assessment, the department makes up the balances and lists the securities received or delivered for each customer. If the client has bought bonds from the bank's bond department, the bank would not be likely to make a charge for their purchase as the charge is included in the commission or the price of the bonds. The securities department keeps a card file, with a card for each foreign client whose securities are in the bank's safe-keeping, showing the name of the client, any special instructions regarding the purchase, sale, or shipment of securities, etc., and the security balance at the end of the semiannual period.

All coupons sent to the bank by foreign clients for collection are received by the foreign securities department, and are checked to see that their number is correct and that the proper United States income tax certificate is attached. Their receipt is then entered in a coupon book, after which they are turned over to the domestic coupon collection department for collection. When advice of payment is received, the entry in the book is stamped out and the proper account is credited and advised. The domestic customers' securities department detaches and tenders to the coupon collection department for collection all coupons on bonds belonging to foreign clients. When the coupons are collected, an advice of payment is sent to the foreign customers' securities department, which makes entries and advises the clients. The coupon book has columns to record the date of the letter remitting the coupons for collection, the name of the account, the name of the coupon, the dollar amount of the coupon, the signature of the coupon collection department, and the stamp-out or remarks.

The foreign securities department is also responsible for the proper handling of all income tax matters in connection with the bank's foreign clients. When collections of foreign dividends are made abroad, the department sees that the proper income tax certificate is received and later sent to the Collector of Internal Revenue. By government regulation the nominee or the custodian of stocks and bonds is responsible for the filing of all income tax returns for income received from sources in the United States by non-resident aliens.

New Foreign Accounts Department

Some banks organize a special department to procure new accounts and to keep the old customers of the bank favorably disposed toward the institution. The general duties of such a department are to solicit and accept new accounts of persons or firms living abroad, to open the new accounts, to inform and to keep the client informed as to the terms and conditions upon which the account is opened and continued, to keep the client supplied with check books and other necessary supplies, to receive and interview customers or their representatives visiting the bank, to handle the correspondence connected with the foreign accounts such as complaints, inquiries, etc., to ascertain the cause of the closing of an account, and to seek to maintain and extend the good-will of the bank among its foreign customers.

Such a department is in a position to create and maintain good-will for the bank, as well as to perform useful services for present and prospective customers. The handling of disgruntled customers with tact and diplomacy, each in the language and according to the customs of his country, requires no small degree of ability. Correspondence with new and old customers must be couched in diplomatic language, and the personal visit of the foreign client or his representative to the bank must be made agreeable and attractive. To anticipate the client's needs for supplies is the surest way to provide against complaint.

The department is very intimately related to the officers of the bank who are responsible for the conduct of the bank's affairs abroad. The procurement of new accounts in the Caribbean region, for instance, and their care after they have been procured are of direct concern to the officer who handles the Caribbean affairs. In fact, the department relieves the officers of much detail and correspondence relative to the opening of new accounts, and the members of the department keep in constant touch with the officers for their information, advice, and direction. In the organization and development of any bank's foreign division such a department can unify effort, work out the best and most feasible plans, give an undivided attention to getting and nursing new accounts, and in the light of comparative results improve the bank's methods and campaign to develop its foreign business.

Soliciting and Opening New Accounts

Practices differ in the soliciting of foreign accounts. Some banks are aggressive, sending traveling representatives into the field, or mailing circulars to solicit trial accounts of desirable parties, or establishing foreign branches from which their publicity and services radiate. Other banks are passive and do not seek new accounts. Others, again, may take an intermediate course and merely follow up any foreigner for whom they may have performed a service or with whom they may have had business dealings. In the near future the tendency of banks will undoubtedly be to push more aggressively their commercial and financial penetration of foreign countries, and active campaigns for accounts will become as common abroad as in the domestic field. As yet, American banks are just formulating their policies in these matters.

Whether or not an account is acceptable to the bank depends upon circumstances. When, for instance, an application is made by letter or personal visit, or by another party (possibly by another customer, at home or abroad) the question at once arises as to whether the bank has ever done any business for or with the applicant, whether it has credit information in its credit files about the prospective client, etc. For illustration, suppose a foreign client asks the bank by letter or cable to place certain funds to the credit of another foreigner who has no account with the bank. A clerk at once begins an investigation to learn whether the bank has ever had any business with the prospective client. He canvasses the files of the credit department and the dossier of his own department and possibly of other departments, such as the letter of credit department, and he has the signatures on the letter verified in the signature department, or the telegram authenticated by the cable department or approved by the officer in general charge of this area.

If after this investigation it is deemed desirable to open an account with the party, the clerk fills in an instruction form, addressed to either the foreign tellers' department or the foreign collection department—depending upon the department from which the funds for the opening of the account have been received, and reading:

> Date........, Tellers' (Collection) Department. Please open a new account in favor of............address............ amount of initial deposit..........per letter (cable) instructions dated........received from............by............

The form also recites the special instructions to be followed in handling the account.

This instruction sheet and the original letter or cablegram of instructions are signed by the officer who has charge of the area where the new customer resides, and the two documents are sent to the department in charge of the funds in question. After the funds have been collected, an account-opened card is prepared jointly with the foreign bookkeeper's department, giving the date, name, address, initial deposit, business, how secured, and remarks. This card is submitted to the officers at their next meeting for discussion, approval, and determination of conditions controlling the account. Copies of the card are then made and distributed among the departments concerned with the new account and a letter is written to the customer stating the terms and conditions under which his account is accepted.

If the prospective customer or his representative comes alone or is introduced by a domestic client to the bank, he is interviewed by the new accounts department, data are procured to guide the officers in passing upon the application, and the normal terms under which accounts are opened are explained to the prospective client. Such a conference affords the department a good opportunity to explain the nature of the services offered by the bank and the advantages of opening an account with it.

When, for some reason or other, an account is closed and the last of the funds withdrawn, the new accounts department prepares an account-closed card jointly with the foreign bookkeeper's department, stating the account's name, address, amount withdrawn, average balance for the preceding six months, business, how closed, and the reason if any for closing the account. This card is considered at the next meeting of the officers, and is filed for permanent record. If the case warrants it, the department may write to the customer diplomatically expressing regret that the account has been closed and hoping that the bank may again be favored, etc.

In the handling of accounts certain miscellaneous duties devolve upon the new accounts department, a few of which may be mentioned: A customer, present or prospective, often writes to the bank for information about the terms and conditions governing accounts, or he may be dissatisfied with certain services of the bank, or he may ask for higher rates of interest on his balance or seek other services or changes in the conditions governing the account, or the client may be in need of bank stationery or a blank check book. These requests, inquiries, and complaints must be handled with tact and diplomacy. Any changes made in the method of handling the account must first be approved by the officers and then recorded, after which the bookkeeper's and other departments are informed of the changes. Another kind of duty performed by the department is to watch for changes in an account's title when partners are added or firms are incorporated or combinations are effected; changes in the official staff of the account or in the persons authorized to sign for the account; the expiration and renewal of certain powers of attorney; etc. Proper notices and records of all such changes are put through the bank.

CHAPTER LXIII

THE FOREIGN BOOKKEEPER'S DEPARTMENT

General Duties of the Department

Upon this department converge the debit and credit tickets, letters and cables and advices, and all items affecting the foreign accounts of the bank, including its accounts with foreign correspondents and the accounts of foreign banks and individuals with it, their joint accounts with it, and incidental personal and capital accounts. The master function of the department is to keep the permanent final and controlling records of the bank's foreign transactions in complete and accurate form. As custodian of these records, the department is a source of reference before payments are made for or against an account and is therefore the guardian of the funds of the bank and its foreign customers. In addition to the keeping of books, the department passes upon signatures, issues and receives advices and confirmations, prepares data for officers, and performs other miscellaneous duties which devolve upon the department because of its possession of the records. The department's work may, accordingly, be classed under two general heads: (1) the routine miscellaneous activities, and (2) the entry and proving of debits and credits to accounts.

The apportionment of these duties among clerks varies, of course, with the bank, as also do the books kept. It is characteristic of all banks, however, to divide the clerks into groups to handle certain related books; for example:

1. The bills payable bookkeepers, who keep the depositors' drafts advised and outstanding books, the drafts paid without advice books, and the stop-payment book.

2. The "their" accounts ledger men.
3. The accounts current men.
4. The "our" accounts ledger men.
5. The general ledger men.
6. Men handling miscellaneous ledgers.
7. The file clerks.

Miscellaneous Routine Duties

Some of the miscellaneous routine duties of the department are as follows:

1. It may be arranged to have a copy of every letter written in the foreign division sent to the foreign bookkeeper's department, where those communications affecting an account are given to the bookkeeper in charge of the entries pertaining thereto and the others are sent directly to the files. All letters are checked in such a way that from the corresponding check mark made in the ledger the bookkeepers can tell at a glance the nature of the letter checked or the kind of advice sent and whether the item has been confirmed by letter from the foreign customer.

2. The department head keeps a dossier of semiprivate mail which includes such matters as new business, special transactions, and special conditions governing certain accounts. All such correspondence must be very carefully read and the accounts affected must be checked according to the special arrangements.

3. The department prepares certain information for the officers and others. Such information embraces lists of the accounts in certain parts of the world for the officer in charge of the territory; the figures regarding interest-bearing and non-interest-bearing accounts; the number of accounts opened and accounts closed; the amount of foreign deposits; lists of the accounts overdrawn; etc.

4. The department keeps a cabinet of the signatures relating to the accounts in the foreign bookkeeper's, letter of credit, commercial credit, and foreign customers' securities departments,

together with those of prospective accounts. By means of these specimen signatures, the signatures on draft advices and on all payments made by the foreign tellers', the commercial credit, and the letter of credit departments are verified. In the domestic division, the verification of signatures as described in Volume III, Chapter XXIX, is done by a specialized signature department; a similar specialized department may be created to handle the foreign signatures, but in the absence of such, the verification can be best done by the bookkeepers who are most familiar with the account.

5. The department head signs all foreign drafts that come through the foreign tellers' department or other departments.

6. Besides the advices, notices, etc., mentioned above, the departmental mail contains letters and cables pertaining to the bookkeeping which must be answered by the department, as well as letters giving balances, transcripts, and reimbursement memoranda to be handled in accordance with special or standing instructions. A card file of these instructions is kept for reference.

The Bills Payable Bookkeepers

One of the most important divisions of the general ledgers is the bills payable or Depositors' Drafts Advised and Outstanding account. This account records the amount of the drafts drawn on the bank or its interior correspondents by its foreign correspondents. It is almost an iron-clad rule with every foreign bank to advise all their drawings immediately. After the signatures on these advices have been verified, they are ready for entry in the bills payable books. It is the custom, with few exceptions, to charge the account of the foreign correspondent immediately upon receipt of their advice by debiting "their" account and crediting bills payable or Depositors' Drafts Advised and Outstanding. The letter of advice is used as the debit ticket. The advices are first sorted and then entered in the respective books and proved. The record includes the date of receipt of advice, the date on which the draft was drawn, the number of the draft, the beneficiary's name, and the amount. When later a draft is presented, an entry in the books is looked for which corresponds in every particular with the draft presented, and the date of presentation is stamped after the entry.

As the clearances (foreign drafts presented through the clearing house) are received through the check desk department of the domestic division, they are sorted into bundles and alphabetically arranged. After the indorsements have been carefully examined and verified, they are paid by stamping the advice entry in the book. Those items that remain open constitute the balance that day. Drafts which have not been advised are reported to the head of the department, who refuses or sanctions their payment as the case may be. After the clearances are stamped out, each bookkeeper adds up his bundle separately, and the total of all must equal the total with which the department is charged by the check desk department, after certain allowances have been deducted for returns, exchange on drafts, etc.

Advices of drafts drawn by foreign correspondents on interior correspondents of the New York bank are spoken of as "countries" by the metropolitan bank. The New York bank furnishes its foreign correspondents with a list of correspondents in the United States, Canada, and our territorial possessions upon which they may draw. It is unnecessary for the foreign bank to advise the interior correspondent. When countries are received by the New York bank they are immediately confirmed to the interior banks. The advice gives them full particulars of the draft, such as the date, number, payee, amount, and drawer, and it requests the interior bank either to honor the described draft and reimburse itself by drawing its own draft on the New York bank and attaching the foreign draft, or to reimburse itself in whatever other way it prefers. The general method for the interior bank is to reimburse itself by drawing on the New York bank. At the time of the advice the New York bank may inquire of the interior bank whether it has funds with which to honor such draft; or the New York bank may transmit funds by telegraph to the interior bank or may tell it that its account has been credited for the amount involved. Nearly all such drafts bear the legend, "In case of need with the ....Bank of New York," which is a direction that in case the draft is presented before receipt of the New York bank's confirmatory letter, the interior bank can immediately communicate with the New York bank for instructions.

Drafts drawn on domestic correspondents may be subject to an exchange charge which varies with the location of the drawee city. This feature is explained to the foreign correspondents in a list of domestic correspondents furnished to them by the New York bank. The bank has also a standing agreement with these domestic correspondents that they will honor such drafts for a certain exchange charge, and if they honor them at par they add their exchange to their reimbursement draft.

The bills payable books, or depositors' drafts advised and outstanding books, are divided into alphabetical parts, as A to C, D to L, M to N, O to R, and S to Z. In them are entered the actual advices of drafts drawn by the foreign correspondents on the bank and its interior correspondents.

Other books of these bills payable bookkeepers are:

1. Drafts paid without advice, wherein are entered drafts that have been paid without advice; in such cases confirmatory advices are requested.
2. Return book, wherein are entered drafts which were originally issued on the bank but did not belong to it, or which were returned for any other reason. If, for instance, the draft is returned for want of a confirming advice, as soon as the relative advice arrives, the department notifies the holding bank that it is in position to pay it. This service is much appreciated by the correspondent banks, as it saves them the bother and expense of protest.

3. Depositors' drafts advised and outstanding, *credits*, wherein credits are entered, principally drafts drawn without advice, and entered from credit ticket.
4. Depositors' drafts advised and outstanding, *debits*, wherein debits are entered; this book is used principally for entries of:
   (a) Cancellations of drafts previously advised.
   (b) The total amount of drafts certified by the certification department.
   (c) All drafts paid by the foreign tellers' department.
   (d) All drafts paid through the clearing house.
5. Stop-payment book, wherein are entered all drafts on which payment has been stopped by letter or cable.
6. List of domestic correspondents, a book with key showing the exchange charges of the bank's domestic correspondents.

The "Their" Accounts Books

One set of books is devoted to "their" accounts, which are the accounts of foreign banks, bankers, firms, and individuals carrying deposit accounts *with* the bank. The "their" accounts show their balances with the bank in United States dollars, and the bank renders statements of "their" accounts from time to time to them. The books covering "their" accounts are as follows:

1. *The "Their" Accounts Ledgers.* These ledgers are alphabetically arranged according to the various cities in which the accounts are located, as A to C, D to L, M to N, O to R, and S to Z. Each ledger is in two parts, the first containing the accounts of banks and bankers, and the second the accounts of firms and individuals. The function of these books is to serve as a check on the current account sheets which are kept in another set of books, and also to enable one to find the balance of an account and to judge of its relative activity.

It is the duty of the men in charge of these books to post the debits and credits from the various departments of the bank. Most of the posting is done in the afternoon and the remainder the first thing in the morning. All postings having been made, the balances are then carried forward and the totals proved against the general bookkeeper's total for the same book.

In addition to this, the ledger men may keep a record of the balances in a specially prepared book, for making up the average balances of the accounts at the end of each month. These averages may also be kept on special cards for quick reference.

It is also necessary for the ledger men to hold against the balance of any account, when properly notified, the various amounts needed for the paying of drafts or making transfers of funds or payments of any kind.

2. *The Account Current Books.* These are the most important set of books in the foreign bookkeeper's department. In them is kept an accurate record in detail of each transaction passing over an account. The descriptions must be so accurate and plain that there can be no doubt as to what is meant when it comes to the hand of the one in whose name the account is kept. The books are divided into alphabetical sections, for banks and bankers, and for firms and individuals; as, banks and bankers, A to B, C to G, H to L, M to P, Q to R, S to Z, and branches; firms and individuals, A to G, H to M, N to P, Q to Z; and segregations.

The men in charge of these books receive from the ledger men all the material that is to be posted, and after they have entered this they strike the balance of the accounts on which they have had transactions and compare the same with the balance on the ledger.

Each account current man at the end of the month makes out the interest due on the accounts in his book. It is very important for the account current men to watch the conditions of each account, as there may be a variety of conditions in force. For instance, the agreement with one account may be to allow interest on deposits *value date of receipt*, and with another to credit interest *value next day*. Interest is so figured that any sum can be valued back to any desired date and thereby the interest can be adjusted to both parties concerned.

Another thing the account current men must watch is the standing plan of reïmbursement agreed upon in case a foreign party has overdrawn its account through a heavy drawing or payment. The arrangement may be for the bank to reimburse itself by drawing on some London bank in sterling and to credit the London bank's account here at the prevailing rate for sight drafts on London, or it may be to draw on banks in Paris in francs, etc. Still other instructions may be to draw on some foreign bank or bankers at 60 or 90 days and credit them with the proceeds. The bank also may have standing instructions to remit the excess of certain balances, or the entire balances when they reach certain sums. Such remittances are made by sending the London or Paris bank a draft on London or Paris or whatever they may desire and debiting their account here at the selling rate for sight drafts on London or Paris, as the case may be, for the equivalent of such drafts.

The conditions under which each account is operated are kept on condition cards, arranged alphabetically according to city, and then by name. On these are entered all conditions coming to the department which govern the account, and also the opening date, the closing date, and the debit and credit balance interest rates.

The account current men check off against the postings on the accounts the advices and credits which are sent to the correspondents, as well as on incoming letters and cables requesting the bank to make payment or transfer funds from one account to another. After these incoming letters and cables are checked off, they are turned over to the file department.

At the end of each month the account current men rule off the statements of the accounts, check the balances with the ledger men, and send them out, keeping a copy of the same. Before the statements are sent, the balances are transferred to a new set of sheets.

The " Our " Accounts Books

"Our" accounts are those maintained by the bank with banks and bankers abroad. These banks make their statements to the bank in terms of the currencies of their respective countries, but in the bank's own records the transactions are kept in terms of United States dollars.

The accounts are operated under widely varying conditions, which are entered on "our" account cards arranged alphabetically according to city and then according to name. It is the duty of these bookkeepers to see that the foreign bank complies with these conditions.

If the arrangement is to charge drafts only upon payment, these bookkeepers must see that they are not charged immediately on receipt of advice, for it is possible that only through the additional interest earned by not charging drafts to the account until paid will the account show a profit. Most payments made on behalf of the bank are charged on the date of payment.

Many banks charge a fee for payments made by them, either a rate ranging from one-half per mille to one-eighth per cent, or, in case of payment in the interior, rates according to a tariff filed with the bank; a minimum charge for small items is often in force. The tariff for letter of credit payments may differ for simple and confirmed credits and for the tenor of commercial credit drafts which they accept. Charges for crediting the bank's account with the proceeds of remittances are less frequent. Bill stamp charges are paid in most countries and sometimes are charged twice on the same bill, as when the first charge is deducted by a bank in another city from the face of the bill sent to them for collection and remittance of proceeds to the New York bank's correspondent, which may again charge for the stamp without actually affixing one.

Bills remitted to a foreign correspondent are not always credited on the day of receipt, particularly if the bills cannot be collected that day; the arrangement is usually mutual, however, and if the New York bank credits bills sent to it on date of receipt, the bills it sends are credited on date of receipt by the correspondent. Some banks stipulate that the items must be received before noon to get credit on that date.

Credits for coupons collected are subject to the most widely varying restrictions. If they are payable at the bank to which they are sent, they are usually credited to the same day; otherwise, interest on these amounts may be deferred from 1 to 6 days.

To recoup the expenses of administration, many foreign banks apply their charges at a certain percentage of the turnover or total of transactions; at the end of the month or semester they charge commission in account. It may be applied only to transactions of certain classes, or to the total debits or credits in the account, or both. The auditing department makes up these totals and applies the percentage and reconciles this result with the amount charged by the foreign banks. The auditor also keeps close watch on the interest debited or credited to the bank's foreign balances. The rate charged on debit balances is larger than that allowed on credit balances by margins varying from 1 to 4 per cent or more; in a few cases the rates are fixed at 1 per cent above or below the bank deposit rate, which rate depends upon the rate set by the central bank of the country.

The "our" accounts bookkeepers devote their morning to posting tickets, striking balances, checking cable books, and checking outgoing mail, and their afternoon to the incoming mail, special attention being given to this on account of value dates.

The books consist of the "our" account general ledgers, the control ledger, and certain subsidiary books or cards.

1. *The Control Ledger.* In the control ledger all tickets pertaining to the "our" accounts are entered in bulk, and then a balance is struck which should prove with that of the general bookkeeper's department. It also acts as a check on the account current balances in the "our" accounts general ledgers.

2. *The "Our" Accounts General Ledgers.* In these all transactions affecting "our" accounts are itemized.

The General Ledger

This ledger is divided into parts, the accounts being segregated for convenience. The accounts include among others the following:

1. Acceptances Based on Imports and Exports (see pages 1276–1280).

2. Letter of Credit Sundries.

3. Customers' Liability under Letters of Credit (see pages 1277–1280).

4. Customers' Liability Account of Acceptances Based on Imports and Exports (see pages 1277–1280).

5. Anticipated Payments under Commercial Letters of Credit (see page 1280).

6. Bills Remitted Depot (see page 1208). This account consists of bills purchased by the bank and remitted abroad to correspondents to be held at its disposal.

7. Funds Received for Foreign Tellers' Drafts (see pages 1244–1246). This account represents drafts received for proceeds of collections sent to the bank's correspondents. The amount of this draft or check is placed in this account until it is paid. It is a clearing account for transfers of payment.

8. Bills Payable Long Bills Account (see page 1223–1224). This account contains the long bills drawn by the bank and sold to customers here in the United States.

9. Funds Retained on Bills Awaiting Collection Account (see page 1213). From time to time the bank takes bills from its

customers here on various foreign countries, and, instead of paying them the full face amount, only advances them a certain per cent. The rest is placed in this account until the collection is made.

10. Brokerage Account (see page 1186). The money to be paid to brokers, which they have earned by buying and selling exchange through this bank, is accounted here.

11. Suspense Account. This is a debit balance account representing money due to the bank from customers which it has paid out for their account.

12. Unpaid Exchange Account (see page 1222). In the sale of exchange this account takes the place of cash or check in payment of same and is therefore a debit account. When the funds come through in payment of the exchange, the receiving teller credits Unpaid Exchange, which settles the transaction.

13. Sundries Account. This is a credit account composed of money that has been sent to the bank for the credit of parties that either do not have an account here or are not known. Upon proper identification this money is paid to these persons and the account is charged. This account also represents money on the disposition of which the bank has received definite instructions.

14. Bills Discounted, Bills Remitted, Sundry Account; Bills Discounted, Bills Remitted, South American Account; Bills Discounted, Bills Remitted, Special Account. (See pages 1205–1210, 1213, 1214.) These and similar accounts are explained by their titles. Such account is charged when a bill is bought from a customer, and it is credited upon receipt of payment from the correspondent who received the offsetting debit.

Other Books

1. *Joint Account Book* (see pages 1200–1201). It frequently happens that transactions of a special nature are made on a joint account basis; that is, each part to the account is operated separately, but for the mutual profit of both. Any profits or losses

arising from these transactions are divided at certain periods. The records in the "their" account and the "our" account books are copied into a joint account book to show the operations of both sides.

2. *General Ledgers.* These cover various foreign accounts, such as Anticipated Payments Advanced Against Merchandise, Suspense, Collections, etc.

3. *Sundry Ledgers.* Into these are posted the sundry items, both alphabetically and according to the department from which they come, so that if at any time it is desired to see whether some bank or individual has funds or sundries, reference may be had to the index without going through the whole book.

4. *Daily Earnings Book.* This is made up daily and sent in the early morning to the general bookkeepers' department, and shows the amount of interest received and paid out each day.

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