

Bankers' Acceptances

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The volume of short-term credit extended through bankers' dollar acceptances has grown very substantially since the end of World War II. This growth has reflected the unique character of the bankers' acceptance as an instrument for financing the expanding volume of international commerce, as well as the high quality attributed to bankers' acceptances by investors of short-term funds. This article describes the nature of bankers' acceptances and the market for them as it has existed in recent years.†

Bankers' dollar acceptances outstanding increased almost steadily from a level of \$104 million at the end of May 1945 to a record high of \$3,467 million at the end of May 1965; a total of \$3,464 million was outstanding at the end of April 1966. The postwar revival in the use of acceptance credit followed a long period of virtual extinction during the depression and war years. After reaching a peak of \$1,732 million at the end of 1929, the volume of acceptances outstanding declined steadily with the shrinkage of international and domestic trade in the 1930's. During the four years of United States involvement in World War II, the month-end volume outstanding ranged roughly between \$100 million and \$200 million. After the war, the renaissance of normal international commerce, the reestablishment of currency convertibility, the new role of the dollar as a free world reserve currency, and the vast capacity of the United States credit market all combined to generate a burgeoning worldwide demand for dollar acceptance financing. As a result, the market for bankers' acceptances has become significantly broader and more active, although it is by no means as important a segment of the total money market as it was in the 1920's, when the vol-

ume of other high-grade short-term paper outstanding was much smaller.

BANKERS' ACCEPTANCES AS A FINANCING DEVICE

A bankers' acceptance usually comes into being in connection with a commercial transaction in which a buyer of goods is obligated to make payment to the seller. In most cases the buyers and sellers are importers and exporters who are located in different countries. Consequently, the credit standing of each may well be unknown to the other. Dollar acceptance financing provides a means whereby an internationally known American bank assumes the obligation to pay the amount involved at a given time in the future.

In order to establish the bank's obligation, the importer or the exporter, or an agent of either, draws a time draft on the American bank. The draft is a written order for the American bank to pay a certain amount of money in dollars (the amount involved in the commercial transaction) to a designated recipient (usually the party who draws the draft) on a specified date in the future, say ninety days after the date the draft is drawn or after the date it is presented to the paying bank. Upon presentation, if the draft has been authorized by the bank and is found to be in order as described below, it will be stamped "Accepted" and signed by an officer of the bank. By this action, the bank unconditionally assumes liability for payment of the obligation when it matures (in this case in ninety days) even if the party for whom it was created fails to reimburse the bank. A bankers' acceptance is therefore a time draft drawn on and accepted by a bank.

The process of acceptance financing may be traced through by means of a characteristic example, such as the importation of goods into the United States from abroad. One way of handling such a transaction would be for the United States importer to approach his bank with a re-

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quest for acceptance credit. If the bank agrees to finance the importer, it would send a letter to the foreign exporter (or to the exporter's bank) advising him that the credit has been established. The letter, generally known as a commercial letter of credit, would authorize the exporter to draw a time draft (described earlier) on the American bank. The bank would agree—for a fee—to accept the draft when it is presented, provided it is accompanied by certain documents related to the underlying commercial transaction, as specified by the importer. Documents most usually required are an invoice describing the goods shipped and the terms of sale, a bill of lading giving evidence of the shipment and conveying title to the goods, and evidence that the goods are insured. When arrangements for the shipment have been completed, the foreign exporter draws the time draft on the American bank and delivers it to his local bank, together with the required documents. At this point, the exporter may receive cash immediately by, in effect, selling the draft to his bank. However, the amount paid for the draft would be less than its face value, in order to compensate the bank for handling costs and risks and to allow a return to the bank on the money advanced on an obligation that does not become payable until sometime in the future. The difference between the face amount of the draft and the amount paid to the exporter by his bank is known as a discount, and the draft is then said to have been discounted.

The exporter's bank then forwards the draft to the American bank, which examines the accompanying documents. If it finds them to be in order, the bank accepts the draft as described above, thereby making it a bankers' acceptance. Once the draft is accepted, the obligation to pay it at maturity is irrevocably assumed by the bank, although the importer is, of course, obligated to reimburse the bank at, or prior to, the maturity of the acceptance.

The acceptance thus created is then ordinarily discounted for the foreign bank by the accepting bank, i.e., the accepting bank pays the face amount less its discount charge to the foreign bank. Even after the deduction of this amount, the foreign bank receives enough to reimburse it for the amount originally paid to the exporter since, as will be recalled, the exporter was paid less than the face amount of the acceptance.

The accepting bank may now retain the discounted instrument in its own portfolio, in which case it is similar to a loan by the bank, and the amount of the discount charged to the exporter's bank becomes an earning to the accepting bank. More commonly, the acceptance would be sold by the accepting bank to an acceptance dealer or directly to a customer of the bank at the prevailing rate of discount for prime bankers' acceptances. In the latter

case, the bank would recoup the money paid to the foreign bank and would therefore have "lent" only its name and credit standing to the importer. The ultimate buyer of the acceptance, a domestic or foreign investor, would actually provide the funds to finance the importation of the goods.

There may be variations in this pattern. For example, the terms of the import transaction might call for immediate payment by the United States importer. Instead of drawing a time draft on the importer's bank as above, the exporter might draw a sight draft on the importer. This draft would be a written order for the importer to pay the amount involved as soon as the draft is presented to him. If the importer's bank agreed to extend acceptance credit to him, the importer would draw a time draft on the bank, ordering it to pay the importer the amount involved at a future date, say in ninety days. The bank would accept this draft upon presentation and would discount the resulting acceptance by paying the importer the face amount less the bank's discount charge. The funds would be used by the importer to pay the exporter's sight draft on him, while deferring any drain on the importer's cash until the maturity of the acceptance. By that time, the importer would presumably have received and sold the goods and would be in a position to reimburse the bank in time for it to pay the maturing acceptance.

Under still another variation, if the import transaction calls for payment by the United States importer at a future date, the foreign exporter rather than the importer might make arrangements for the acceptance credit. In this case, the exporter's local bank would request its American correspondent bank to accept a time draft drawn upon the American bank by either the exporter or his bank. The resulting draft would be accepted and discounted by the American bank, as above, and the funds would be paid to the exporter through his own bank. The eventual payment for the goods by the importer, under the terms of the commercial transaction, would enable the exporter to repay his bank, which in turn would repay the American bank in time for it to meet the acceptance at maturity.

A primary function of the acceptance is to enable the seller or exporter of goods to obtain cash as soon as possible (by discounting the acceptance) while permitting the buyer or importer to defer payment, at least until the goods have been received and sold. Acceptance credit may also finance the accumulation of goods by an exporter who has contracted to ship them abroad within a reasonable time (a pre-export acceptance). A foreign exporter, for example, having contracted to sell goods abroad, might arrange through his local bank to have an American bank extend acceptance credit. The proceeds of the credit would

be used by the exporter to purchase and ship the goods. Acceptances may also be used to finance an importer until he can distribute the goods into the channels of trade (a post-import acceptance). In this case, an importer may arrange for a bank to finance the temporary carrying of imported goods which are expected to move within a relatively short time.

Dollar acceptances have been used to an increasing extent in recent years to refinance other credit arrangements previously made between buyers and sellers. For example, Japanese trading companies in the United States export goods to Japan and draw either sight or time drafts on the United States agency of a Japanese bank. The agency finances the shipment by discounting the draft for the trading company and then forwards the draft to its home office in Japan, together with the accompanying documents that will be needed by the Japanese importer. The home office of the Japanese bank refinances the shipment, or a number of shipments, by drawing a time draft on an American bank, which accepts and discounts the draft, thereby creating a dollar acceptance. The proceeds of the discounted acceptance reimburse the Japanese bank and/or its agency in the United States for the money it had paid to the Japanese trading company in the United States.

Only about 115 institutions in the United States—those that emphasize international transactions—currently engage in any significant volume of acceptance financing. These institutions include commercial banks and Edge Act Corporations,¹ two private banks, foreign banking corporations, and United States agencies and branches of foreign banks. The bulk of acceptances is created by institutions in New York City and in the San Francisco Federal Reserve District, reflecting the importance of these strategically located banks in the financing of international trade.

A prime bankers' acceptance, i.e., an acceptance of a bank whose name has gained recognition in the marketplace as one that is experienced and active in creating acceptances, is considered an investment of top quality by holders of short-term funds. This quality depends mainly upon the unconditional obligation of the acceptor, which is a widely known and respected, although not necessarily a large, financial institution. Virtually all acceptances trade at the prime rate—not to be confused with the prime rate on direct loans—and rates are not publicly quoted for paper that is not prime. In addition, the

drawer of the bank draft and any unqualified endorsers are contingently liable to pay the instrument in the event that it is not paid by the acceptor. The sale of the goods involved in the underlying transaction is expected to generate funds that, directly or indirectly, will enable the borrower to liquidate his indebtedness to the accepting bank. Moreover, the liquidity and attractiveness of prime bankers' acceptances are enhanced by their eligibility for discount or purchase by Federal Reserve Banks if the paper conforms to certain conditions set forth in Regulations A, B, and C of the Board of Governors of the Federal Reserve System. Regulation C describes such commercial drafts or bills as those growing out of any of the following transactions:

- (1) the importation or exportation of goods,
- (2) the shipment of goods between foreign countries,
- (3) the storage of readily marketable staples in the United States or in any foreign country, and
- (4) the shipment of goods within the United States.

Acceptances, to be eligible, must mature within six months of the date of acceptance and should bear evidence of the nature of the underlying transaction in a form satisfactory to the Federal Reserve Bank.²

TYPES OF ACCEPTANCE FINANCING

INTERNATIONAL TRADE. The bankers' acceptance is especially adaptable to the financing of international trade, and such acceptances constitute the bulk of total acceptances outstanding (see table). Chief among United States imports typically financed by acceptances are coffee, sugar, iron and steel products, wool, and textile products. United States exports most frequently financed by acceptances are grains, machinery and parts, cotton, ores, oil, and iron and steel (including scrap). In connection with trade between foreign countries, acceptances drawn on banks in the United States most frequently finance transactions in oil, ores and metals (chiefly iron), wool, cotton,

¹ For a description of the organization and operations of Edge Act Corporations, see the article "Edge Act and Agreement Corporations in International Banking and Finance", this Review, May 1964, pages 88-92.

² A member bank may not extend acceptance credit of more than 10 per cent of its paid-up and unimpaired capital and surplus to any one borrower unless the bank is secured for that portion in excess of 10 per cent by documents or other security arising out of the transaction. In addition, the total amount of drafts accepted by a member bank may not amount to more than 50 per cent of its paid-up and unimpaired capital stock and surplus except with the special permission of the Board of Governors of the Federal Reserve System, which may allow a maximum of 100 per cent of capital stock and surplus; domestic acceptances, however, are limited to 50 per cent of capital and surplus in any event. There are no restrictions on the amount a member bank may invest in eligible acceptances of other banks.

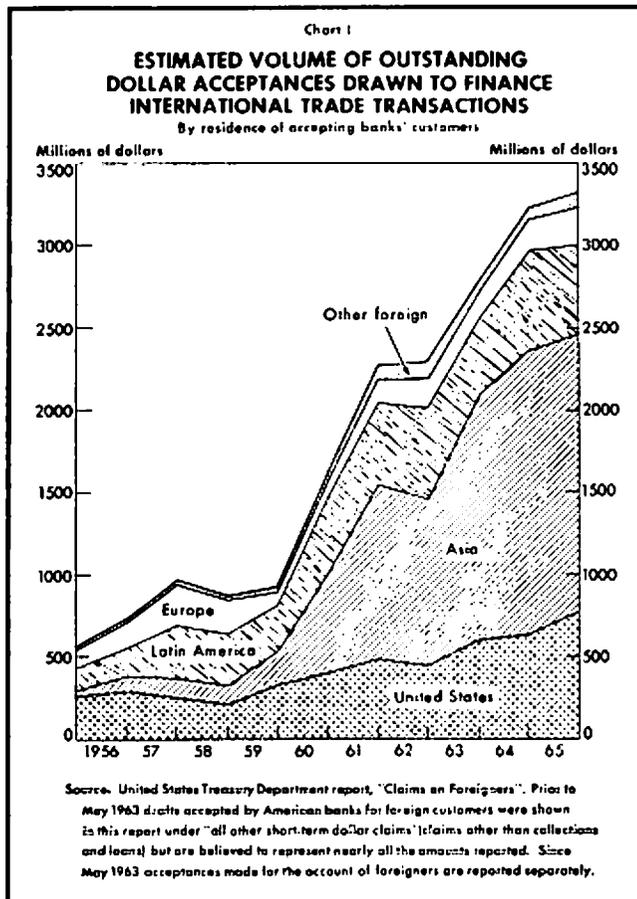
grains, sugar, and rubber. The volume of dollar acceptances financing international trade has more than doubled since the end of 1960. A major portion of the growth has been in acceptances covering trade between foreign countries (known as third-country trade), which about tripled during the same period. Acceptances against United States imports have also grown steadily, although at a much slower pace, while the year-end volume of export acceptances has been relatively stable since 1961.

As indicated in Chart I, borrowing by foreigners has been primarily responsible for the growth of dollar acceptances during the 1960's, while acceptance borrowing by firms domiciled in the United States has increased much more slowly. The rise in foreign borrowing has been mainly by the Japanese, who have accounted for most of the Asian borrowing shown on the chart. As already indicated, acceptance credit is especially tailored to the financing of international trade, and such trade is of vital importance to the Japanese economy. Moreover, with interest rates in Japan generally at a very high level, Jap-

anese merchants and bankers have intensively utilized the comparatively cheaper credit available in the United States to finance their expanding world trade. To a lesser extent, there has been an increase in the extension of acceptance credit to Latin American borrowers, mainly to finance exports to the United States and a growing volume of trade among Latin American countries. In contrast, the volume of dollar acceptances used by Europeans has been relatively small and reflects the more active utilization by Europeans of financing alternatives, including the Euro-dollar market. European credit has been more readily available and somewhat more competitive with United States credit than Japanese and Latin American credit facilities.

DOMESTIC TRADE. Bankers' acceptances have long ceased to be used in significant volume to finance domestic trade. At the close of April 1966, there were only \$20 million of acceptances outstanding for this purpose, of which \$11 million were created to finance the shipment of goods within the United States and \$9 million were to finance the storage of certain types of goods pending their further movement into trade. Business practice in the United States has never encouraged the use of bankers' acceptances to finance domestic shipments of goods since most such transactions customarily involve the direct extension of credit by the seller to the buyer, without any formal written obligation. Furthermore, in order for domestic shipment acceptances to be eligible for Federal Reserve discount or purchase, they must bear a certification that, at the time of acceptance, shipping documents conveying or securing title were attached or were in the physical possession of the accepting bank or its agent. Because of inconveniences related to this requirement and the availability of other means of financing, banks have not encouraged the use of acceptances for the financing of domestic shipments.

In the past, most domestic acceptances financed the storage of readily marketable staples such as cotton, grain, rice, wool, or tobacco. To be eligible for Federal Reserve discount or purchase, storage acceptances must be secured by a warehouse receipt or other such document conveying or securing title to the stored goods. Control of the warehouse involved must be completely independent of the borrower, and the goods should be stored pending a reasonably prompt sale, shipment, or distribution into the process of manufacture. Domestic storage acceptances have not been created in any significant volume in recent years (see table), partly because direct bank loans, even after allowing for compensating balances, have been cheaper to the borrowers involved, many of whom are able to borrow at the "prime rate". At no time since late 1961



DOLLAR ACCEPTANCES OUTSTANDING, CLASSIFIED BY TYPE OF TRANSACTION

In millions of dollars

Type of transaction	1929	1939	1945	1950	1955	1960	1961	1962	1963	1964	1965	April 1966
International trade	1,348	163	128	364	562	1,596	2,273	2,293	2,792	3,231	3,330	3,410
Imports into the United States	383	102	103	245	252	403	485	541	567	667	792	829
Exports from the United States	524	39	18	87	210	669	969	778	908	999	974	875
Goods stored in or shipped between foreign countries	441	22	7	32	100	524	819	974	1,317	1,565	1,564	1,706
Domestic trade	308	54	26	28	63	308	293	171	41	43	35	20
Shipments	23	10	12	10	9	13	18	12	9	12	11	11
Storage	285	44	15	18	54	295	275	159	32	31	24	9
Dollar exchange	76	16	*	2	17	122	117	186	56	111	27	34
Total	1,732	233	154	394	642	2,027	2,683	2,650	2,890	3,385	3,392	3,464

Note: Data refer to end of period. Because of rounding, figures do not necessarily add to totals.
* Less than \$500,000.

has the cost of acceptance financing (including both the accepting bank's commission and the cost of discounting) been lower than the commercial bank prime lending rate on direct loans. Also, since 1958, the Commodity Credit Corporation has been financing most domestic storage of cotton, thereby minimizing the need for private financing for this purpose. Prior to that time, the seasonal financing needs of cotton merchants generated a large volume of storage acceptances whenever relative costs favored acceptance financing over other sources of credit.

DOLLAR EXCHANGE ACCEPTANCES. Dollar exchange acceptances are time drafts drawn by banks (usually the central bank) in certain foreign countries and accepted by banks in the United States, for the purpose of creating dollar exchange.³ Thus, dollar exchange acceptances do not arise from specific merchandise transactions but are designed to alleviate seasonal shortages of dollar exchange for certain countries, when it can be reasonably expected that the credit will be subsequently liquidated from funds acquired in the normal course of trade. Most frequently, dollar exchange acceptances have been drawn by Latin American banks. To be eligible for Federal Reserve discount or purchase, dollar exchange acceptances may

not have an initial maturity exceeding three months and may only originate in a limited number of countries designated by the Board of Governors.

The volume of dollar exchange acceptances has fluctuated widely (see table), and a total of only \$34 million was outstanding at the end of April 1966. Political and economic unsettlement in some Latin American countries has limited the use of dollar exchange acceptances. However, the expanded use of pre-export acceptances in some countries tends to furnish dollar exchange in a less direct manner. In contrast to dollar exchange acceptances, the eligibility of pre-export acceptances for Federal Reserve discount or purchase depends on the existence at the time the acceptance is created of an actual contract to ship specific merchandise. Such a contract gives pre-export acceptances a larger element of self-liquidity.

THE COST OF ACCEPTANCE FINANCING

The cost of acceptance financing consists of a commission charged by the accepting bank plus all charges involved in the handling and discounting of the accepted draft. For prime customers, a much broader group than in the case of direct loans, the commission charge of United States banks is usually 1½ per cent, but higher rates may be charged for others. The rate of discount charged is normally the current market bid rate of acceptance dealers for the appropriate maturity. At the end of April 1966 this rate was 5½ per cent for three-month acceptances. The combined commission and discount charge for three-month acceptance financing for a prime

³ The total amount of dollar exchange acceptances that a member bank has outstanding may not exceed 50 per cent of its paid-up and unimpaired capital and surplus, with a maximum of 10 per cent for any one drawer (unless fully secured). This limitation is separate and distinct from, and in addition to, the limitations prescribed with respect to the acceptance of commercial drafts (see footnote 2, page 129).

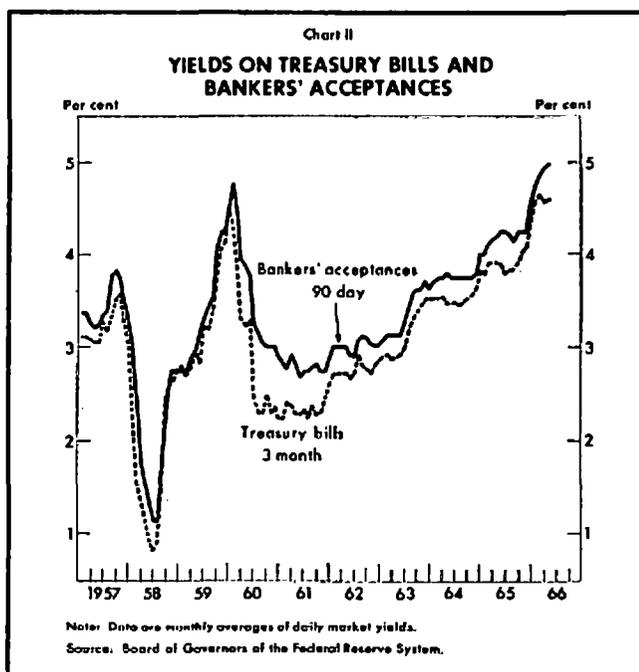
borrower was, therefore, 6½ per cent. Whether the acceptance commission, the cost of discounting, and charges of intermediary banks are to be paid by the exporter or importer depends upon which party arranged for the credit and on the terms agreed upon in the underlying commercial transaction. In the case of pre-export and post-import financing, however, the exporter or importer, respectively, being in each case both the borrower and drawer of the related drafts, would normally pay the entire cost of financing.

The cost of alternative financing opportunities, particularly direct bank loans, exerts a significant influence on a borrower's willingness to finance his transactions by acceptance credit. Thus, the volume of acceptances would be expected to increase if their cost is low relative to direct loans and to contract when acceptance financing is relatively costly. However, when banks are under reserve pressure, they may actively encourage borrowers to use acceptances rather than direct loans, since the banks can then sell the acceptances in the open market and conserve their cash resources. A comparison of the relative costs of borrowing on acceptances versus direct loans must take into account the indirect cost of maintaining compensating balances in the case of direct loans (where these balances exceed the borrower's normal transactions balance needs). Also, as noted above, the minimum acceptance commission of 1½ per cent applies to many borrowers that would not be able to obtain direct loans at the prime rate.

The cost of borrowing in foreign countries may exert some influence on the volume of dollar acceptances. For example, large active borrowers might shift their demand for credit to London if the cost of sterling acceptances dropped significantly below that on dollar acceptances, assuming there were no British governmental restrictions on the financing of foreigners. The borrower would have to repay in sterling and would normally hedge the exchange risk by buying sterling for future delivery. He would therefore have to consider the premium or discount on forward sterling in arriving at the net cost of sterling acceptance financing.

BANKERS' ACCEPTANCES AS AN INVESTMENT

The tested safety and high degree of liquidity of prime bankers' acceptances make them a useful vehicle for the investment of short-term funds. Over the years, market rates for bankers' acceptances have usually been only slightly higher than those for United States Treasury bills (see Chart II), and at times the Government's bills have actually sold at the higher of the two rates. It should be noted that the prime character of an accepting bank's



name does not necessarily depend on the size or location of the bank but rather upon the bank's reputation for knowledge and skill in the field of international lending. Thus the acceptances of well-known smaller banks with proven experience in the financing of international commerce are traded in the market at the same rate of discount as those of the largest accepting banks. This is quite different from the situation in the market for negotiable time certificates of deposit, where a substantial concession may be required to induce investors to buy the paper of a smaller bank despite a long history of prudent and successful management. As noted above, the liability of endorsers and drawers, the presumption (except in the case of dollar exchange acceptances) of the existence of a self-liquidating commercial transaction underlying each credit, and eligibility for Federal Reserve discount and purchase all contribute to the quality of prime bankers' acceptances, although the importance attached to each of these considerations varies among different types of investors. Corporate buyers of acceptances, for example, reportedly rely almost solely on the obligation of the accepting bank.

THE MARKET FOR BANKERS' ACCEPTANCES

Bankers' acceptances are negotiable and marketable short-term obligations. As such, they may be bought or

sold in the market, competing with other short-term obligations such as Treasury bills, commercial paper, and negotiable certificates of deposit for the attention of investors. Participants in the market are acceptance dealers, accepting banks, foreign and domestic investors, and the Federal Reserve System.

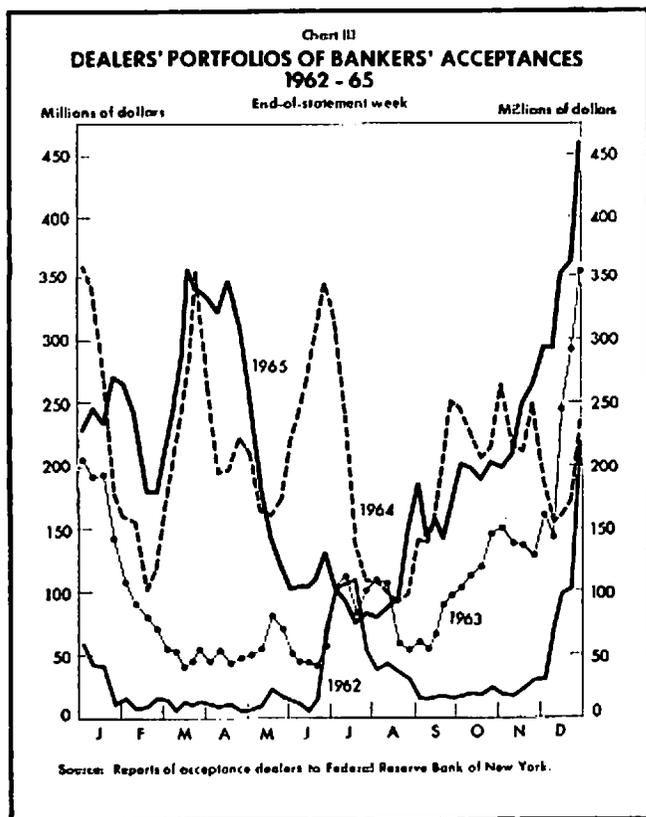
DEALERS. Six dealers regularly conduct operations in bankers' acceptances. All are located in New York City and all but one actively deal in other money market obligations. These dealers stand ready to buy and sell various maturities of prime bankers' acceptances at publicly posted prices which are quoted in terms of a rate of discount from the face value of an acceptance. Rates of discount are higher for longer than for shorter maturities because of the increased risk of a rise in interest rates over the longer period and because of the need to provide increased compensation to the ultimate investor for committing his funds for a longer period of time. The rate of discount at which dealers will sell acceptances is normally $\frac{1}{8}$ per cent lower than the rate at which they will buy acceptances of the same maturity. This spread is the principal source of the dealers' income. Although the spread

is currently larger than dealers' spreads for some other short-term obligations, acceptances are relatively costly to handle because of the number of individual acceptances usually involved in a single transaction and because of the need for careful examination to establish the eligibility and negotiability of the instruments. For example, a dealer buying \$1 million of acceptances might have to process thirty or forty individual instruments while a similar transaction in Treasury bills might involve only one piece of paper.

Dealers' bid quotations also provide the basis for the discounting of acceptances by accepting banks, as described above, and any changes in dealers' posted rates are immediately communicated by the banks to their customers and correspondents around the world. Dealers' quotations are usually not subject to very frequent changes since the cost of discounting acceptances is an important consideration in the negotiations constantly under way between international buyers and sellers of goods. Subject in varying degree to these considerations, dealers' rates for bankers' acceptances fluctuate in response to persistent movements in other short-term money rates and to marked changes in the level of dealers' portfolios. During 1965, there were only nine occasions when a majority of the dealers changed their rates.

Prior to November 1963, dealers conducted their operations in bankers' acceptances with very small portfolios in relation to turnover. During the years 1955 through 1962, the annual average position of all dealers combined ranged from about \$5 million to \$35 million and dealers frequently found it impossible to satisfy the demand of investors. More recently, however, dealers have been carrying much larger portfolios, averaging around \$210 million in 1964 and 1965 (see Chart III). Portfolios have been particularly heavy over most quarterly statement dates, reaching a record level of \$461 million on December 31, 1965, as banks relied heavily on sales of acceptances to help meet seasonal reserve needs. Dealer portfolios are usually financed by call loans from commercial banks in New York City. The Federal Reserve Bank of New York also makes funds available to dealers under repurchase agreements at times when the reserve effect of such accommodation is consistent with the System's general monetary objectives.

ACCEPTING BANKS. Investors who buy acceptances do not normally resell them but hold them until maturity so that, once placed with investors, relatively few acceptances find their way back into the market. Therefore, dealers are dependent upon sales by accepting banks as the major source of supply. The willingness of banks to sell their acceptances varies significantly with changes in general money



market conditions. Accepting banks tend to hold a large proportion of their own acceptances in their portfolios in the absence of pressure on bank reserves. On the other hand, when banks are under pressure they may sell newly created acceptances or those that they had been holding. This enables them to recoup the funds paid out when they discounted the paper and to transfer the extension of credit from themselves to the ultimate buyers of the acceptances. Thus, between the end of 1964 and the end of 1965, when banks came under gradually increasing pressure, the percentage of outstanding acceptances held by accepting banks (including acceptances of other banks) dropped from 49.4 per cent to 36.1 per cent. This meant that acceptances were more readily available to other investors than in 1964. Many banks sell some portion of their acceptances directly to their customers, bypassing the dealer market, although the banks depend upon the dealers to absorb their bills at times of money market strain and lagging investor demand. Both accepting and nonaccepting banks are also important buyers of other banks' acceptances as an investment when rates on acceptances are relatively attractive vis-à-vis other short-term obligations.

FOREIGN INVESTORS. Investors abroad have long recognized the highly safe and liquid character of bankers' acceptances and consider them attractive assets for the placement of short-term funds. Consequently, foreign central and commercial banks and, to some extent, nonbank foreign investors, are important holders of bankers' dollar acceptances. Accepting banks have among their foreign bank customers many who require acceptances with two bank names. These acceptances are obtained predominantly through swapping operations with the dealers. The accepting bank sells its own acceptances to the dealer at his buying rate, say $5\frac{1}{4}$ per cent, and buys back the acceptances of other banks at the dealer's selling rate ($5\frac{1}{8}$ per cent). When selling these acceptances to a foreign bank, the selling bank generally adds its own endorsement, charging $\frac{1}{8}$ of 1 per cent commission for assuming the related risk. The net rate of discount to the foreign bank, based on the above example, would be 5 per cent. Foreign demand for endorsed bills has reportedly been declining somewhat in recent years as nonbank investors, and even some banks, have been satisfied with only one bank name, so that swapping operations presently constitute a smaller proportion of total dealer activity than they did in the late 1950's.

DOMESTIC INVESTORS. Domestic investors in acceptances, other than commercial banks, include savings banks, insurance companies, and a variety of nonfinancial corporations. Corporations have shown increasing interest in acceptances in recent years whenever acceptance rates be-

come sufficiently attractive relative to rates on Treasury bills, commercial paper, and negotiable time certificates of deposit. Some disadvantages of acceptances as an investment, such as their comparatively small and oddly denominated amounts, lack of convenient maturities, and uncertainty of adequate supply, are being overcome to some extent. The large-scale refinancing of Japanese trade through dollar acceptances, for example, has produced larger acceptances in round amounts (most frequently \$100,000) and with attractive maturity dates, covering not one but many individual shipments of goods. These multiple-type acceptances are purchased by the Federal Reserve Bank of New York, provided the underlying transactions are adequately described on each acceptance or on an attachment thereto. Also, the larger positions regularly carried by dealers since late 1963 have increased the possibility that an investor can obtain sufficient bills of a desired maturity at a given time to satisfy his requirements. Domestic investors buy unendorsed acceptances almost exclusively, depending upon the obligation of the accepting bank to provide sufficient safety.

FEDERAL RESERVE BANK OPERATIONS. The Federal Reserve Bank of New York purchases a substantial volume of acceptances in the dealer market for its foreign correspondents and for its own account. Acceptance holdings for foreign accounts amounted to \$144 million as of December 31, 1965. The Federal Reserve Bank (whether for its own account or for foreign accounts) buys only endorsed bills, i.e., acceptances bearing three names—those of the acceptor, of the drawer, and in most instances, of an endorsing dealer. The rate of discount to the buyer of endorsed bills is $\frac{1}{16}$ per cent less than that for two-name paper (unendorsed bills). In addition, the Federal Reserve Banks guarantee payment of acceptances purchased for the account of foreign correspondents, charging $\frac{1}{8}$ of 1 per cent for the guarantee. Therefore, if endorsed bills were offered by dealers at $5\frac{1}{16}$ per cent discount, the net return to foreign correspondents on acceptances purchased for them by the Federal Reserve Bank of New York would be $4\frac{1}{16}$ per cent. The contingent liability arising from the guarantee is participated among the twelve Reserve Banks—as are the proceeds of the guarantee fees.

In 1955, the Federal Open Market Committee authorized the Federal Reserve Bank of New York to purchase acceptances from the dealers for its own account and to make repurchase agreements with nonbank dealers against bankers' acceptances, as part of its open market operations for the Federal Reserve System. The purpose was to encourage the postwar redevelopment of the bankers' acceptance market and to demonstrate official recognition

of the high quality and usefulness of these instruments in international finance. This participation in the market also affords the Reserve Bank added opportunities to examine the quality of the paper flowing through the market as an aid to the fulfillment of the System's traditional supervisory function in this area. In recognition of the increasing importance of bankers' acceptances, a separate Acceptance Department was created at this Bank in January 1964.

Outright holdings of acceptances by this Reserve Bank for its own account have been deliberately limited to marginal amounts. At the close of 1965, the peak of year-end seasonal pressures on the money market, these holdings amounted to \$75 million, only 2 per cent of total acceptances outstanding.

CONCLUSION

Bankers' dollar acceptances have become increasingly important in the financing of international trade during the postwar era, and particularly since the mid-1950's, as acceptances have proved their usefulness to borrowers, banks, and investors. The market for these instruments has also grown and acceptances have been competing with other short-term investment media. Much of the growth has reflected the intensive use of the instrument by the Japanese. The prospects for further growth in the use of acceptances seem good, particularly if they should come to be utilized more intensively by the developing countries of South America, Africa, and Southeast Asia.