Office Correspondence

FEDERAL RESERVE BOARD

Date July 9, 1935.

To GOVERNOR ECCLES

Subject: CLAYTON ACT - BANKING ACT OF 1935.

From Mr. Paulger

FEDERAL RESERVE BOARD

10-852

111.2-40

In revising the existing provisions of the Clayton Act, Section 329 of the Senate draft provides, with certain exceptions, that:

FOR CIRCULATION

Mr. Hamlin
Mr. Miller
Mr. James
Mr. Thomas
Mr. Szymczak
Mr.
Mr.
Mr. Morrill
Mr. Bethea
Mr. Carpenter
Mr. Noell
Mr.
Mr.
Mr.

Please note — check and return to Mr. Carpenter

"No director, officer, or employee of any member bank of the Federal Reserve System or any branch thereof shall be at the same time a private banker or a director, officer or employee of more than one other bank, banking association, savings bank, or trust company organized under the National Bank Act or organized under the laws of any State or of the District of Columbia, or any branch thereof, except in the case of any one or more of the following or any branch thereof: etc., etc."

In view of what the original Clayton Act attempted to correct, it would seem that the phrase "of more than one other bank, etc." simply nullifies the important restrictions against interlocking directorates and managements of banks. While interlocking bank directorates may be advantageous in a small community where there is a dearth of material for directors, I feel that as a general proposition it is not desirable, and unless Congress has in mind specifically to change a policy of long standing, the above permissive phrase should be eliminated.

In the attached memo, Messrs. Crays and Sloan have discussed one or two other matters, which, while important to the Board from an administrative standpoint, do not involve the important question of fundamental change of policy.

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date July 8, 1935.

To Mr. Paulger

From Messrs. Crays & Sloan

Subject: Re: Section 329 of the "Banking Act of 1935" as reported by the Sub-committee of the Senate Banking and Currency Committee.

10—852

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Section 329 of the "Banking Act of 1935" as drafted and reported by the sub-committee of the Senate Banking and Currency Committee prohibits a director, officer or employee of any member bank of the Federal Reserve System or any branch thereof, from being at the same time a private banker or a director, officer or employee of more than one other bank, banking association, savings bank or trust company organized under the National Bank Act, the laws of any State or of the District of Columbia, or any branch of such bank. This prohibition, however, is subject to seven (7) enumerated exceptions and a further exception to the effect that until February 1, 1939, it shall not prohibit any director, officer, or employee of any member bank of the Federal Reserve System, or any branch thereof, who is lawfully serving at the same time as a private banker or as a director, officer or employee of any other bank, banking association, savings bank, or trust company, or any branch thereof, on the date of enactment of the Act, from continuing such service.

The Section is designed to replace the presently existing provisions of Sections 8 and 8A of the Clayton Antitrust Act.

"As outlined by the Judiciary Committee, in reporting the original bill to the House, the purpose of Section 8 of the original Clayton Act was 'to prevent as far as possible control of great aggregations of money and capital through the medium of common directors between banks and banking associations, the object being to prevent the concentration of money or its distribution through a system of interlocking directorates.'" (Federal Reserve Bulletin - August 1, 1916, page 389 et seq.).

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With respect to the purpose of Section 8A of the Act, the Board stated at page 53 of its 1933 Annual Report that "While the purposes of this section are not entirely clear, it is believed that they are generally to prevent a too close association or community of interest between national banks and nonbanking lenders on securities and to supplement other provisions of the Banking Act of 1933, which were designed to discourage corporations engaged in commerce or industry from making loans to brokers or dealers in stocks and bonds, i.e., the so-called 'brokers' loans for account of others.' It seeks to accomplish these objects by preventing individuals associated with organizations which make loans on the security of stock or bond collateral from serving at the same time as directors, officers or employees of banks organized or operating under the laws of the United States.

"It is not believed that this section was actually intended to prevent the same person from serving as director, officer or employee of two or more banks - - - -;" nevertheless, the Board felt that such a conclusion was inescapable and so interpreted this provision.

The elimination of Section 8A as it now stands is probably not a serious loss. At the present time the so-called "brokers' loans for account of others" which it was designed to discourage have been largely eliminated from the picture or provided for otherwise and the evils incident thereto at this time appear chimerical although it is conceivable, of course, that their reality may be experienced again at some future time.

It is believed important, however, to direct attention to some of the permissive features of Section 329 in the light of the original purpose of Section 8 of the Act. To this end, attention is called to the following features

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of Section 329:

1. "No director, officer, or employee of any member bank of the Federal Reserve System or any branch thereof shall be at the same time a private banker or a director, officer or employee of more than one other bank, banking association, savings bank, or trust company organized under the National Bank Act or organized under the laws of any State or of the District of Columbia, or any branch thereof, except in the case of any one or more of the following or any branch thereof: (Underscoring supplied)

2. "(5) A bank, banking association, savings bank, or trust company not located and having no branch in the same city, town or village as that in which such member bank or any branch thereof is located, or in any city, town or village continguous or adjacent thereto. (Underscoring supplied).

3. "(6) A bank, banking association, savings bank, or trust company not engaged in a class or classes of business in which such member bank is engaged."

4. The provision exempting from the prohibitions of the Act until February 1, 1939, those individuals who are lawfully serving more than one bank on the date of the enactment of the Banking Act of 1935.

These permissive features will be considered in the order listed.

1. Under (1) above, a director, officer or employee of a member bank of the Federal Reserve System may serve one other bank without restriction. There appears to be nothing in the Act to prevent, for example, a director, officer or employee of the Chase National Bank of New York from serving at the same time as a director, officer or employee of The National City Bank of New York or one other large banking institution located in the City of New York and in direct competition with it. Similarly, directors, officers or employees of The Philadelphia National Bank, Philadelphia, Pennsylvania, may serve as directors, officers, or employees of Central-Penn National Bank, or Girard Trust Company

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or one other large banking institution located in Philadelphia and in direct competition with it. Thus it would be possible for the Philadelphia National Bank to have one of its twenty-five directors serve upon and, perhaps, dominate the boards of directors of each of twenty-five other institutions in Philadelphia. The same would be true, of course, with respect to dominant banks in other financial centers. Under the existing provisions of Section 8, the Board in the exercise of the discretion lodged with it, has felt service of this nature to be in contravention of the spirit and purpose of the Clayton Act and in many cases involving circumstances of this kind has withheld its approval. If there is anything to be gained from such legislation, it is believed that the action of the Board in such cases has been justified.

Due to the effects of the economic crisis through which the country has been passing, many large cities have been left with not more than two or three banking institutions. The proposed Section 529 will not prevent interlocking service of bank directors, officers or employees with two banking institutions in the same city, town or village in spite of the fact that such service might result in a lessening of competition and a restriction of credit.

It is believed that the vast majority of interlocking directorates in existence today involve only two banks with the result that the prohibition of Section 529 resolves itself largely into no prohibition at all. The interlocking service which has hitherto been considered harmful, of a harmful nature, or as possessing harmful "potentialities" will not be prevented, for many cases, the individual involved can restrict his service to two institutions and at the same time operate to control and throttle the credit facilities of the community.

If interlocking bank service is not harmful it would appear that no prohibition against such service was necessary; if such service is harmful in some cases then any prohibition against such service should be sufficient to prevent the existence of harmful relationships. This result cannot be attained by permitting an individual to serve two banks without restriction.

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2. Since Section 329 authorizes and directs the Board of Governors of the Federal Reserve System to enforce compliance with it and to prescribe such rules and regulations as it deems necessary for that purpose, it appears that the Board will find itself under the necessity of determining and defining when a city, town or village is contiguous or adjacent to another. While this may not involve any particular difficulty, doubtless the inclusion of the phrase "or in any city, town or village contiguous or adjacent thereto" in exception number 5 will occasionally, if not frequently, require the Board's consideration of those circumstances which it will be contended are "unusual or peculiar." Of greater moment than this, however, it is believed that the inclusion of the phrase may result in certain inequities that will not be counterbalanced by the good accomplished. As Mr. Leonard pointed out in his memorandum of April 24, 1935, to you, "It takes less than two hours to go from New York to Philadelphia, and a man could serve as a director of a large bank in each city actively competing for loans of large industries. It takes about two hours for a manufacturer living in Evanston (Illinois) to go to his manufacturing plant in the lower south side of Chicago. Evanston prides itself on being a cultured residential suburb of considerable wealth. The industrial section in the lower south side of Chicago presents an entirely different picture with a large foreign population of factory workmen. Does the public interest require that the manufacturer be prohibited from serving as a director of the Evanston bank, his home community, and the other bank (located in the lower south side of Chicago) which has been organized largely with his aid for the benefit of the workmen in his factory?" It may be that our manufacturer is a civic leader who has been requested, because of his ability, to serve two Chicago banks; he also feels

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called upon to serve the bank catering to the needs of his workmen in the lower south side of the city or in East Chicago, Indiana. Is he to be permitted to serve the two Chicago banks which are in direct competition without restriction while he is prohibited from serving also the bank serving his factory employees? Or is he to be prohibited from serving a Chicago bank and the bank catering to his employees while another may serve two Chicago loop banks without restriction?

3. It is not believed that exception (6) is any exception at all except as "class or classes of business" may be defined. Accepting deposits may be termed a class of business although it may be determined that commercial and savings deposits represent different classes of business. In any event, it is rare indeed that banks accepting distinct classes of deposits do not make some loans of the same character. For instance, few commercial banks are without some real estate loans and few savings banks are without some loans secured by stock or bond collateral.

4. As set forth under (1) few individuals would need the benefit of exemption for the period until February 1, 1939, if the Act is passed as proposed.

Past experience indicates that deferring the effective date of prohibitive legislation engenders agitation for amendment prior to the effective date.

While the provision is not open to direct criticism of consequence, the need for it and the possible effect of it are both open to question.

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