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November 1, 1938.

Memorandum for the Files:

At a conference in the office of Governor McKee on the afternoon of Monday, October 31, which was attended by Messrs. Cagle, Dreibelbis and Morrill, a communication dated October 31, 1938, signed by H. E. Small, President of the Morris Plan Bankers Association, in regard to the amendment adopted by the Board on August 31, 1938, eliminating the words "Morris Plan bank" from paragraph (a) of section 3 of Regulation L, was presented on behalf of the Morris Plan Bankers Association by Mr. Small, Mr. Robert O. Bonnell, President of The Public Bank, Baltimore, Maryland, and Mr. Richard H. Stout, Field Secretary of the Morris Plan Bankers Association.

The letter of October 31 covers the ground of the oral discussion during which the point of view of the Morris Plan Bankers Association was presented and the reasons of the Board for the adoption of the amendment were indicated. Governor McKee stated that at the first opportunity when there could be a meeting of the Board for the purpose the information submitted on behalf of the Association would be faithfully repeated so that all of the members of the Board would have the benefit of the discussion.

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Secretary.

CM yd

(letterhead of)

MORRIS PLAN BANKERS ASSOCIATION

Washington Building
Washington, D.C.

October 31, 1938.

Board of Governors of the
Federal Reserve System
Washington, D. C.

Gentlemen:

Section 329 of the Banking Act of 1935, which became effective August 23 of that year, amended Section 8 of the Clayton Act relating to interlocking directorates. The amended section 8 had the effect of providing that directors of a member of the Federal Reserve System or of a bank organized under the laws of the United States would not be eligible to serve as a director of any other bank, with certain exceptions, on or after February 1, 1939. But amended Section 8 further provided that notwithstanding the above the Board of Governors of the Federal Reserve System may by regulation permit such service to a director of not more than one other such institution.

Authority was given the Federal Reserve Board to issue any regulations it deemed necessary to enforce compliance with the provision of Section 8. Pursuant to that authority, Regulation L, dated January 4, 1936, was issued by your Board, which provided for certain exceptions under Section 8 of the Clayton Act relating to interlocking directorates. These exceptions, set out in Section 3, paragraph (a) of the Regulations, permitted directors to serve on the boards of not more than "one Morris Plan bank, cooperative bank, credit union or other similar institution".

Under the 1935 Banking Act and the interpretation of Regulation L just mentioned, all banks, with the exceptions set forth above, were required to reorganize their boards so as to terminate any interlocking directorates before February 1, 1939, or in a period of approximately 3½ years.

Under date of August 31, 1938, however, the Federal Reserve Board amended Regulation L (Section 3, paragraph (a), by eliminating from the original regulation the words "Morris Plan bank". This has the effect of requiring Morris Plan institutions to reorganize their Boards of Directors in order to comply with the provisions of Regulation L as amended within a period of five months, instead of the three and a half year period allowed commercial banks for compliance.

Morris Plan institutions are whole-heartedly in favor of efforts to strengthen and stabilize banking in the United States, and are in sympathy with the desire of your Board to eliminate abuses to which interlocking directorates contributed. However, the compliance with the provisions of Regulation L as amended August 31 of this year presents to Morris Plan institutions an almost insurmountable problem, in the solution of which the Morris Plan Bankers Association earnestly solicits your cooperation.

In order to furnish you the facts pertinent to the dilemma in which we now find ourselves, the following is submitted:

It is generally conceded that Morris Plan institutions were the pioneers in furnishing on a nationwide basis consumer credit facilities. It was recognized that if the operations of these pioneer institutions were to be conducted successfully and the development of consumer credit as a component part of the credit structure of the country was to be an orderly one the best banking brains available in each community where such institutions were organized should be enlisted in the undertaking. Consequently, a sizable number of the original directors of Morris Plan institutions were members of the banking fraternity, and from time to time other bankers have been added to these Boards.

The success of Morris Plan institutions over a period of more than a quarter of a century would indicate that the above policy was a sound one. Even the financial debacle of 1932 and 1933 left Morris Plan institutions, as a group, with an enviable record. It would appear, therefore, that, insofar as Morris Plan institutions are concerned, interlocking directorates have proved to be a stabilizing and strengthening influence. But it is apparent that the very policy which has been followed by a substantial number of Morris Plan banks increases theirdifficulties in attempting to comply with amended Regulation L.

A hasty survey shows that out of 92 Morris Plan institutions from whom we have heard, 57 of them will lose 199 directors.

In two instances as many as 13 directors will have to be replaced and several will, in a few months, have to find suitable substitutes for from thirty-three to fifty percent of the members of their Boards.

Despite the prestige of these institutions, it would be exceedingly difficult to avoid unfavorable public reaction to the fact that the outstanding bankers and, in many instances, the most prominent citizens of their respective communities are precipitously severing their connections with a financial institution.

It would be even more difficult during the short period left for Morris Plan banks to comply with Regulation L as amended, to persuade equally outstanding citizens, whose advice and counsel as directors would be valuable, to take on additional responsibilities and to make the investment necessary in order to qualify as directors within the five month period allowed; a difficulty which Congress recognized when it fixed a three and one half year limit for compliance by commercial banks. There can be little doubt but what the stability of many Morris Plan banks would be jeopardized.

Under these circumstances, the Morris Plan Bankers Association respectfully urges your Board to give immediate consideration to this problem and to grant Morris Plan institutions an adequate measure of relief from a most embarrassing situation.

For purposes of clarification, we also wish to direct your attention to certain facts, which may be helpful in your consideration of our difficulty.

While all of our member institutions operate "the Morris Plan of Industrial Banking", they are set up to conform with the statutes of the various states under which they were organized and operate. As a result, they divide themselves into three classifications:

1. Banks of deposit accepting personal checking accounts as well as savings or time deposits

2. Banks of deposit accepting only savings or time deposits

3. Corporations organized under other than the Banking Law and not permitted to accept deposits as such but authorized to sell choses in action designated as Investment Certificates, Debentures, etc.

In practically all instances, the banks belonging to group one accept demand accounts only from individuals, the service being rendered in connection with a program to provide a complete banking service for the individual but without any attempt to offer commercial bank accommodations. These banks, obviously, do not solicit nor do they accept commercial accounts.

Banks operating under the second classification are pure savings banks which accept only time deposits. They accept no demand deposits and are in no way competitive with what we generally understand as a commercial bank operation.

The institutions which belong to the third classification are definitely not banks of deposit. This point was recognized when the Federal Deposit Insurance Corporation ruled them ineligible for membership. It, therefore, seems apparent, to us, that Regulation L as amended was never intended to apply to those institutions covered in the third classification.

In the first classification 15 Morris Plan banks are members of the Federal Deposit Insurance Corporation. Of these, 9 would be affected by Regulation L as amended. The most seriously affected are the banks in Duluth, Minnesota; Cincinnati, Ohio; Wilmington, Delaware; St. Louis, Missouri; New York City.

Of the banks falling into group No. 2, 25 are members of the Federal Deposit Insurance Corporation and 8 would be affected, Baltimore and Youngstown the most seriously.

In the third classification 40 institutions will be affected.

Some of these, as pointed out earlier in this letter, would lose the majority of their present directors if they were required to comply with Regulation L as amended. If, however, our assumption is correct that those institutions which are properly grouped in the third classification mentioned above are not subject to the provisions of Regulation L as amended, then our concern is confined to the predicament in which banks grouped in classifications 1 and 2 above now find themselves.

While the act, in its entirety, is aimed at the elimination of interlocking boards of competitive institutions, Congress in amending Section 8 of the Clayton Act of 1935 specifically excepted Mutual Savings Banks. It thereby indicated a willingness to recognize differences of degree in competition.

We must admit that a certain amount of competition exists between all financial institutions, but we respectfully point out that the amount of competition which does exist between the relatively small portion of the commercial bank's business which is handled in its personal loan department and Morris Plan institutions, is not out of line with the competition which exists between commercial banks and mutual savings banks, cooperative banks and credit unions. Consequently the effect of Regulation L as amended appears to be discriminatory against Morris Plan banks in favor of mutual savings banks, cooperative banks and credit unions.

The above action by Congress would appear to furnish your Board justification for any exception it might be willing to make in the case of Morris Plan institutions.

In view of all of the foregoing circumstances, the Morris Plan Bankers Association urges that you re-amend Regulation L as amended so as to permit a director of not more than one Federal Reserve Member bank to qualify as a director of a Morris Plan bank.

Respectfully yours,

(Signed) H. E. Small

H. E. Small
President