F E D E R A L R E S E R V E B O A R D

W A S H I N G T O N

To all Federal Reserve Agents:

The prohibitions of Section 8 of the Clayton Act which relate to interlocking bank directorates go into effect on October 15, 1916. These prohibitions relate to banks organized or operating under the laws of the United States, and, therefore, apply to State banks or trust companies which are members of the Federal Reserve System as well as to national banks. For convenience, therefore, banks "organized or operating under the laws of the United States" will be referred to as "member banks."

ANALYSIS OF SECTION 8 OF THE ACT

As originally enacted, Section 8 of the Clayton Act provides, in substance -

(a) That no person shall be a director, officer or employee of a member bank having resources aggregating more than $5,000,000 and at the same time a director, officer, or employee of any other member bank;

(b) That no private banker or person who is a director of a non-member bank having resources aggregating more than $5,000,000 shall be eligible to serve at the same time as a director in any member bank;

(c) That no member bank in a city of more than 200,000 inhabitants shall have as a director or other officer or employee any private banker or any director or other officer or employee of any other bank or trust company located in the same place.

EXCEPTIONS.

The provisions of Section 8:

(1) Do not apply to mutual savings banks not having a capital stock represented by shares.

(2) Do not prohibit a person from being at the same time (a) a Class "A" director of a Federal reserve bank and also an officer or director, or both an officer and a director, in one member bank; (b) an officer, director or employee of one member bank and one other bank or trust company, whether a member bank or non-member bank, where the entire capital stock of one is owned by the stockholders of the other.

THE KERN AMENDMENT

By an Act of Congress, approved May 15, 1916, Section 8 was amended by the addition of a further proviso reading as follows:

> "Nothing in this Act shall prohibit any officer, director, or employee of any member bank, or Class "A" director of a Federal reserve bank, who shall first procure the consent of the Federal Reserve Board * * * * * from being an officer, director, or employee of not more than two other banks * * * * * if such other bank * * * * is not in substantial competition with such member bank."

The duty imposed upon the Federal Reserve Board in passing upon any application made under authority of this amendment is to determine whether or not the two banks in question (or either of them) are in substantial competition with the member bank. If both are non-member banks the act does not require that they shall not be in substantial competition with each other.

In reaching a conclusion on this point, it will be necessary for the Board to call upon the Federal Reserve Agent, as its local representative, to make investigation of the facts in each case, to report the same to the Board and to give the Board the benefit of his recommendation whether the consent applied for shall be granted or refused. It is, therefore, necessary to call to the attention of the Federal reserve agents some of the factors which must be considered in determining the question of whether or not the banks involved are in substantial competition.

PURPOSES OF THE ACT AND THE AMENDMENT.

The significance of the language "substantial competition" can not be fully understood without considering the purpose of the original act as well as that of the amendment.

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."

It will be observed that the Act does not undertake to prevent interlocking directorates of banks located in small cities and having small aggregate resources. It applies in terms to the qualification of directors, officers and employees of banks (a) in cities of more than 200,000 inhabitants or (b) having resources aggregating more than $5,000,000.

While the general purpose of the Act, as indicated by its title, was "to supplement existing laws against unlawful restraints and monopolies," and while monopolies are created by a restraint of legitimate competition a literal interpretation of Section 8 as originally enacted would prohibit a person from serving at the same time as a director, officer or employee of two or more banks, under certain circumstances, whether or not such banks were competitors. The Kern amendment, however, authorizes the Board to permit a director, officer or employee of a member bank who otherwise would be ineligible, to serve as a director, officer or employee of not more than two other banks or trust companies, whether State or national, provided such other banks or trust companies are not in substantial competition with such member bank.

It should be borne in mind that the Act does not vest an arbitrary discretion in the Board to permit the same person to serve on the board of directors of any two or more banks, when such banks come within the restrictive language of the Act as

originally passed; but it merely confers authority upon the Board to permit interlocking directorates when such banks are not in substantial competition, within the meaning of the Act.

SUBSTANTIAL COMPETITION.

It is manifest that no fixed rule can be prescribed by which this question can be automatically determined. The facts in each case must be carefully considered and it is the duty of the Board to withhold its consent in any case in which it would defeat the purposes of the Act to permit the same person to serve as an officer, director, or employee of more than one bank.

If the two banks in question are not competitors in any respect no question arises. If they do compete the very difficult question arises, whether or not the competition is "substantial".

It is necessary to keep in mind that the main purpose of the Act was to prevent the monopolization and centralization of credit through interlocking directorates of banking institutions. One of the injurious results of such conditions is that the public is deprived of the benefit of legitimate competition.

In general, therefore, two banks coming within the prohibition of the original Act would be deemed to be in substantial competition within the meaning of the language used in the amendment if the business engaged in by such banks under

natural and normal conditions, conflicts or interferes, or if the cessation of competition between the two would be injurious to customers, or would-be customers, or would probably result in appreciably lessening the volume of business or kinds of business of either institution.

It is realized that some difficulty will be experienced in the application of this test.

Two banks engaged in the same character of business (for example, where both receive commercial deposits and make commercial loans) would be regarded as in substantial competition if their fields of activity extended over the same geographical territory. If their operations were not carried on in the same geographical territory, then, although they engaged in the same class of business, they would not necessarily be regarded as substantial competitors.

Again, if they conducted their operations in the same place, but, because of their comparatively small size in relation to the total banking opportunities of the locality, and because of the fact that they did not deal with the same class of customers, the cessation of competition between them might, from the public point of view, be unimportant, they would not necessarily be deemed to be in substantial competition. Or, if their operations were conducted in the same locality but the character of business engaged in differs (for example, where one does a strictly commercial banking business while the other confines its operations

to a trust company or fiduciary business), such banks need not be regarded as in substantial competition.

It is, therefore, necessary to consider the scope or extent of territory that a bank's operations cover and the character and kinds of business it engages in. Size, measured by aggregate resources, will constitute one of the factors to be considered, since to increase the volume of loanable funds usually increases the radius of a bank's operations. A bank with $100,000,000 resources would seek investments in a larger area and of a more diverse character than a bank with $5,000,000, and so might come into competition with banks located some distance away, while the bank with $5,000,000 resources might not extend its activities to any real extent beyond the borders of the city in which it is located. For example, a bank in New York might come into substantial competition with a bank in Chicago if both were engaged in the same class of business and if both had become so large as to be more than local institutions.

Where the operations of the two banks cover a common territory from a geographical standpoint, it is necessary to consider carefully the character of business engaged in. As a very large proportion of the member banks do a commercial banking business, the volume of this business within the territory covered by the operations of the banks in question becomes an important factor. In a city of 250,000 inhabitants any two banks which engaged in a

commercial banking business to any great extent would presumably come into substantial competition, whereas, in a city of 2,000,000 inhabitants one bank might confine its operations to the wholesale district while another might draw its customers exclusively from the retail district, and so might be non-competitive in the sense that an increase of the business of one would not affect the business of the other.

R E S U M E'

It is, therefore, necessary that consideration should be given:-

(1) To the size in aggregate resources of banks involved;

(2) To the character of business engaged in, i. e., the extent of commercial business and extent of purely investment or trust company business of the two institutions.

(3) Whether the operations of the two banks cover the same geographical territory.

(4) Whether the two banks actually compete to any appreciable extent in any important activity - for example, (a) in soliciting deposits on demand or on time from other banks or individuals, (b) in the purchase or sale of commercial paper or other securities, (c) in the purchase or sale of foreign exchange, (d) in soliciting trusteeships, etc.

The form of application approved by the Board is intended to furnish an analysis of the character of business of the banks involved as far as it is possible to determine this from the books of the bank. The Federal reserve agent should supplement this, however, with any information he may be able to obtain and should base his recommendation upon the facts in each case. If he concludes that there is substantial competition between the banks or that interlocking directorates or common officers or employees of the two banks might result in any injury to the public, or in any substantial restraint of or detriment to the business of either bank, he should recommend that the application be refused. The Board, in reaching a decision, will carefully consider the recommendation of the Federal reserve agent and will base its conclusion upon the report and recommendation of the agent together with other information which its own investigation may disclose.

The Kern amendment authorizes the Federal Reserve Board at its discretion "* * * * to revoke such consent." In order that the Federal Reserve Board may revoke its consent at any time it becomes necessary, Federal reserve agents should keep it advised of any change either in local business conditions or in the resources or character of business conducted by the banks which may tend to make them substantial competitors.

In view of the great amount of time necessary to an adequate consideration of each case it is desirable that directors, officers and employees file their applications as soon as possible. The Board will endeavor to act upon all applications received before August 15, 1916, on or before September 15, 1916.

6/23/16.